No. 04-1264

Title: Buckeye Check Cashing, Inc., Petitioner
v.
John Cardegna, et al.

Docketed: March 22, 2005
Lower Ct: Supreme Court of Florida
Case Nos.: (SC02-2161)
Decision Date: January 20, 2005

Questions Presented

~~Date~~	~~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~~~
Mar 21 2005	Petition for a writ of certiorari filed. (Response due April 21, 2005)
Apr 14 2005	Order extending time to file response to petition to and including May 23, 2005.
May 11 2005	Consent to the filing of amicus briefs in support of either party received from counsel for the petitioner.
May 16 2005	Consent to the filing of amicus briefs in support of either party received from counsel for the respondents.
May 23 2005	Brief amicus curiae of Chamber of Commerce of the United States of America filed.
May 23 2005	Brief amicus curiae of Community Financial Services Association filed.
May 23 2005	Brief amici curiae of Florida Bankers Association and American Bankers Association filed.
May 23 2005	Brief of respondents John Cardegna, et al. in opposition filed.
May 27 2005	Reply of petitioner Buckeye Check Cashing, Inc. filed.
May 31 2005	DISTRIBUTED for Conference of June 16, 2005.
Jun 20 2005	Petition GRANTED.
Jul 25 2005	SET FOR ARGUMENT on November 29, 2005.
Jul 26 2005	Extension of time within which to file petitioner's brief on the merits to and including August 12, 2005
Aug 1 2005	Consent to the filing of amicus briefs in support of either party received from counsel for respondents Cardegna and Reuter.
Aug 1 2005	Consent to the filing of amicus briefs in support of either party received from counsel for the petitioner.
Aug 5 2005	CIRCULATED.
Aug 12 2005	Joint appendix filed. (Distributed)
Aug 12 2005	Brief of petitioner Buckeye Check Cashing, Inc. filed. (Distributed)
Aug 12 2005	Brief amicus curiae of Community Financial Services Association of America filed. (Distributed)
Aug 12 2005	Brief amicus curiae of Theis Research, Inc. in support of neither party filed.

(Distributed)

Aug 12 2005 Brief amici curiae of Financial Service Centers of America, Inc., et al. filed. (Distributed)

Aug 12 2005 Brief amici curiae of Chamber of Commerce of the United States of America, et al. filed. (Distributed)

Aug 12 2005 Brief amici curiae of Florida Bankers Association and American Bankers Association filed. (Distributed).

Sep 2 2005 Extension of time within which to file respondents' brief on the merits to and including September 23, 2005.

Sep 23 2005 Brief of respondents John Cardegna, et al. filed. (Distributed)

Sep 23 2005 Brief amicus curiae of Samuel Glazer filed. (Distributed)

Sep 23 2005 Brief amici curiae of National Association of Consumer Advocates, et al. filed. (Distributed)

Sep 23 2005 Brief amicus curiae of AARP filed. (Distributed)

Sep 23 2005 Brief amici curiae of University of Wisconsin Law Professors filed. (Distributed)

Sep 23 2005 Brief amici curiae of Law Professors Robert W. Gordon, et al. filed. (Distributed)

Sep 23 2005 Brief amici curiae of Florida, et al. filed. (Distributed)

Oct 7 2005 Motion of Florida, et al. for leave to participate in oral argument as amici curiae and for divided argument filed.

Oct 18 2005 Petitioner's opposition to motion of Florida, et al. for leave to participate in oral argument as amici curiae and for divided argument.

Oct 25 2005 Reply of petitioner Buckeye Check Cashing, Inc. filed. (Distributed)

Oct 31 2005 Motion of Florida, et al. for leave to participate in oral argument as amici curiae and for divided argument DENIED.

Nov 29 2005 Argued. For petitioner: Christopher Landau, Washington, D.C. For respondents: F. Paul Bland, Jr., Washington, D.C.

Nov 30 2005 Record received from Supreme Court of Florida. (1 box)

041264 MAR 21 2005

No.

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Florida

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Florida Supreme Court erred by holding, consistent with the Alabama Supreme Court but in direct conflict with six federal courts of appeals, that the Federal Arbitration Act allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioner Buckeye Check Cashing, Inc. hereby states that it has no parent corporation, and that no publicly traded company owns 10% or more of its stock.

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INTRODUCTION

Almost forty years ago, in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), this Court held that the Federal Arbitration Act ("FAA") does not allow a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) was fraudulently induced. Such a claim, the *Prima Paint* Court explained, must be presented to the arbitrators in the first instance, because there was no question that the parties had actually made an agreement to arbitrate. Thus, once it is clear that "the making of the agreement for arbitration ... is not in issue," a court may not entertain a challenge to the validity of the underlying contract.

That principle is controlling here, because respondents are challenging the validity of their underlying contracts with petitioner, but their challenge does not implicate "the making of the agreement for arbitration." Respondents neither deny that they assented to an arbitration agreement, nor challenge the arbitration agreement itself as illegal. Rather, respondents contend only that the underlying contracts are illegal as usurious. Under *Prima Paint*, that challenge must be resolved in the first instance by an arbitrator, not a court.

The Florida Supreme Court (like the Alabama Supreme Court in *Alabama Catalog Sales v. Harris*, 794 So. 2d 312, 314 n.2, 316-17 (Ala. 2000)), however, attempted to distinguish *Prima Paint* on the ground that the challenge there (fraud in the inducement) would have rendered the underlying contract *voidable* under state law, whereas the challenge here (illegality) would render the underlying contract *void* under state law. But, as Justice Cantero noted in dissent below (and as Justices See and Lyons noted in dissents in the Alabama case), that is a distinction without a difference. Whether the underlying contract is alleged to be voidable or void as a matter of *state* law has nothing to do the real issue—whether the challenge to the underlying contract implicates "the making of the agreement

for arbitration" as a matter of *federal* law. Not surprisingly, thus, all six federal courts of appeals that have considered this issue have concluded that a party cannot avoid arbitration under *Prima Paint* by challenging the underlying contract (as opposed to the arbitration clause itself) as illegal. *See Jenkins v. First Am. Cash Advance of Ga., LLC*, No. 03-16329, __ F.3d __, 2005 WL 388269 (11th Cir. Feb. 18, 2005); *Bess v. Check Express*, 294 F.3d 1298, 1304-06 (11th Cir. 2002); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 636-38 (4th Cir. 2002); *Burden v. Check Into Cash of Ky., LLC*, 267 F.3d 483, 489-90 (6th Cir. 2001); *Harter v. Iowa Grain Co.*, 220 F.3d 544, 550 (7th Cir. 2000); *3H & Assocs., Inc. v. Hanjin Eng'g & Constr. Co.*, No. 97-16751, 1998 WL 657722, at *2 (9th Cir. Sept. 3, 1998) (unpublished); *Lawrence v. Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1161-62 (5th Cir. 1987). As these courts recognize, *Prima Paint* establishes as a matter of *federal* law that the validity of the arbitration clause is severable from the validity of the underlying contract.

Accordingly, this petition squarely presents a conflict on whether the FAA allows a party to avoid arbitration by challenging the underlying contract as illegal, and hence void *ab initio*, under state law. The Florida and Alabama Supreme Courts have answered that precise question of federal law in a manner that (as the dissent below noted) "disregards controlling federal law and the federal preference for enforcing arbitration clauses," App. 26a. And given that the Eleventh Circuit is among the contrary federal jurisdictions, the upshot is the intolerable situation that a defendant in Florida or Alabama can enforce its federal arbitration rights in the face of an illegality challenge if sued in a federal court, but not in the state court down the street. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 15 (1984) (noting that such disuniformity would "encourage and reward forum shopping" antithetical to the FAA). Because the decision below not only deepens an entrenched conflict between state courts of last resort and federal appellate courts

on a matter of federal law, but also evinces the very hostility to arbitration that motivated the FAA in the first place, this Court's review is warranted.

OPINIONS BELOW

The Florida Supreme Court's decision is reported at __ So. 2d __, 2005 WL 106966, and reprinted in the Appendix ("App.") at 1a-26a. The Florida District Court of Appeal's decision is reported at 824 So. 2d 228, and reprinted at App. 27a-32a. The Florida trial court's unreported decision denying petitioner's motion to compel arbitration is reprinted at App. 33a-34a.

JURISDICTION

The Florida Supreme Court rendered its decision on January 20, 2005. App. 1a. This Court has jurisdiction under 28 U.S.C. § 1257(a).

PERTINENT STATUTORY PROVISIONS

Section 2 of the Federal Arbitration Act provides in pertinent part:

> A written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

Section 4 of the Federal Arbitration Act provides in pertinent part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any ... court ... for an order directing that such arbitration

> proceed in the manner provided for in such agreement. ... The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration ... is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. ... If the making of the arbitration agreement ... be in issue, the court shall proceed summarily to the trial thereof.

9 U.S.C. § 4.

STATEMENT OF THE CASE

A. Factual Background

Petitioner Buckeye Check Cashing, Inc. provides check-cashing and payroll advance services across the country, including Florida. These services allow consumers to obtain immediate cash, either by cashing a check that is deposited forthwith or by writing a check to be cashed at some future date against forthcoming income. Petitioner is licensed to do business in Florida under that State's Check Cashing and Foreign Currency Exchange Act, Fla. Stat. § 560.301, and its conduct is comprehensively regulated under the State's Deferred Presentment Act, Fla. Stat. § 560.401 *et seq*.

Respondents John A. Cardegna and Donna Reuter entered into separate deferred presentment transactions with petitioner. As part of those transactions, the parties signed a Deferred Deposit and Disclosure Agreement that contained an arbitration clause providing in pertinent part:

> Arbitration Provisions. Any claim, dispute, or controversy (whether in contract, tort or otherwise, whether pre-existing, present, or future, and including statutory, common law, intentional tort, and equitable claims) arising from or relating to this Agreement ... or the validity, enforceability, or

> scope of this Arbitration Provision or the entire Agreement (collectively "Claim"), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision. ... This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16.

App. 2a, 27a-28a.

B. Proceedings Below

Notwithstanding that broad arbitration clause (which expressly encompasses "[a]ny claim, dispute, or controversy ... relating to ... the validity, enforceability, or scope of ... the entire Agreement," App. 2a, 27a), respondents filed this putative class action against petitioner in Florida state court in February 2001. The complaint charges petitioner with "shylocking," Compl. ¶ 61, and challenges the validity of the underlying contracts between respondents and petitioner under Florida law. Petitioner promptly moved to compel arbitration under the arbitration clause of those contracts.

The Florida trial court (Barkdull, J.) summarily denied the motion. App. 33a-34a. The court did not deny that respondents' claims fell within the plain language of the arbitration clause, but relied on two Florida intermediate appellate decisions holding that a court, not an arbitrator, must resolve a challenge to the legality of the underlying contract. App. 34a (citing *Party Yards, Inc. v. Templeton*, 751 So. 2d 121 (Fla. Dist. Ct. App. 2000), and *FastFunding v. Betts*, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000)).

Petitioner immediately appealed that order, and the intermediate appellate court reversed. *See* App. 27a-32a. The court noted that respondents "did not argue that they did not

enter into the arbitration agreement, nor did they challenge the validity of the terms of the arbitration agreement." App. 32a. Rather, the court explained, respondents "contend that the underlying contract is void ab initio because it is criminally usurious and, therefore, never existed at all." App. 30a. Relying on the Eleventh Circuit's decision in *Bess* (which in turn relied on this Court's decision in *Prima Paint*), the court held that respondents' challenge to the validity of the underlying contract must be resolved by an arbitrator, not a court, in the first instance. *See* App. 31a-32a.

Respondents then appealed that decision to the Florida Supreme Court, which—in a divided decision—again reversed. App. 1a-26a. The majority held that "an arbitration provision contained in a contract which is void under Florida law cannot be separately enforced while there is a claim pending in a Florida trial court that the contract containing the arbitration provision is itself illegal and void ab initio." App. 1a. *Prima Paint* was not controlling, the majority held, because the challenge to the underlying contract there (fraud in the inducement) would have rendered the contract *voidable* under state law, whereas the challenge to the underlying contract here (illegality) would have rendered the contract *void* under state law. App. 5a-6a. The majority acknowledged that this holding conflicted with the Eleventh Circuit's decision in *Bess*, but asserted that "the case presently before us is distinguishable because *Bess* was expressly resolved under federal law, not state law principles." App. 7a.

Justice Bell concurred specially to acknowledge "that the issue before us is one of federal law." App. 9a. Justice Bell proceeded, however, to "disagree with the conclusions that have been reached" by every federal appellate court to consider the issue. *Id.* According to Justice Bell, "[t]he issue of the underlying contract's legality must be determined by the courts before any claim or dispute arising out of the contract may be

referred to arbitration pursuant to the contract's arbitration clause." App. 12a.

Justice Cantero dissented, noting that "[t]he issue in this case is not whether a check-cashing contract is void as usurious," but "*who decides* whether the contract is void—the arbitrator, as provided in the contract itself, or the court." App. 13a (emphasis in original). That issue, Justice Cantero explained, is one of *federal* law under *Prima Paint*. App. 14a. Justice Cantero further noted that the void/voidable distinction on which the majority relied "is arbitrary and totally disconnected" from the language of the FAA. App. 17a. Indeed, he pointed out, "[i]n the last three years no fewer than three federal courts of appeals have decided the precise issue we confront today—whether, under the FAA, the issue of whether a check-cashing transaction is void as usurious is for the court or the arbitrator to decide," and "*[e]very one* unanimously has held that the issue is one for the arbitrators." *Id.* (referring to *Bess*, 294 F.3d at 1304-06; *Snowden*, 290 F.3d at 636-38; and *Burden*, 267 F.3d at 489-90; emphasis in original). Justice Cantero concluded that "[w]e should follow *Bess*, *Snowden*, and *Burden*, which considered the identical issue under identical facts and held that, under the plain language of the FAA, the issue of whether a check-cashing transaction is usurious must be determined by the arbitrators." App. 20a.

This petition follows.

REASON FOR GRANTING THE WRIT

The Florida Supreme Court Erred By Holding, Consistent With The Alabama Supreme Court But In Direct Conflict With Six Federal Courts Of Appeals, That The FAA Allows A Party To Avoid Arbitration By Claiming That The Underlying Contract Containing An Arbitration Clause (But Not The Arbitration Clause Itself) Is Void For Illegality.

The Florida Supreme Court erred by holding, consistent with the Alabama Supreme Court but in direct conflict with six federal courts of appeals, that the FAA allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality. That holding contravenes this Court's seminal decision in *Prima Paint*, which—as a matter of the "*federal* substantive law of arbitrability," *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (emphasis added)—divests courts of authority to entertain a challenge to the validity of a contract that does not implicate "the making of an agreement for arbitration."

Indeed, this Court granted *certiorari* in *Prima Paint* to decide "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." 388 U.S. at 402. That issue previously had divided the lower courts. The Second Circuit had held that "arbitration clauses as a matter of *federal* law are 'separable' from the contracts in which they are embedded, and that where no claim is made that fraud was directed at the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud." *Id.* at 402 & n.8 (emphasis added; citing, *inter alia, In re Kinoshita & Co.*, 287 F.2d 951 (2d Cir. 1961); *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. granted*, 362

U.S. 909, *cert. dismissed*, 364 U.S. 801 (1960)). The First Circuit, in contrast, had held that "the question of 'severability' is one of *state* law, and that where a State regards such a clause as inseparable a claim of fraud in the inducement must be decided by the court." *Id.* at 403 & n.9 (emphasis added; citing *Lummus Co. v. Commonwealth Oil Ref. Co.*, 280 F.2d 915, 923-24 (1st Cir. 1960)).

The *Prima Paint* Court squarely endorsed the Second Circuit's approach. As the Court explained, "Congress has provided an explicit answer" to the question in the FAA, *id.* at 403, which directs courts to compel arbitration where "the making of the agreement for arbitration ... is not in issue," 9 U.S.C. § 4. Under that provision, the Court held, "the making of the agreement for arbitration ... is not in issue" as a matter of *federal* law where a party to such an agreement challenges the validity of the underlying contract (as opposed to the validity of the arbitration clause itself). *See* 388 U.S. at 404 ("[T]he statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally."). Justice Black dissented on this point, noting that "[t]he Court here holds that the [FAA], *as a matter of federal substantive law*, compels a party to a contract containing a written arbitration provision to carry out his 'arbitration agreement' even though a court might ... hold the entire contract—including the arbitration agreement—void because of fraud in the inducement." *See id.* at 407 (dissenting opinion; emphasis added).

In light of *Prima Paint*, it is not surprising that all six federal courts of appeals that have addressed the issue (the Fourth, Fifth, Sixth, Seventh, Ninth, and Eleventh Circuits) have held that a party cannot avoid arbitration by challenging the legality of the underlying contract (as opposed to the arbitration clause itself). *See, e.g., Jenkins*, __ F.3d at __, 2005 WL 388269, at *11-13; *Bess*, 294 F.3d at 1304-06; *Snowden*, 290 F.3d at 636-

38; *Burden*, 267 F.3d at 489-90; *Harter*, 220 F.3d at 550; *3H & Assocs.*, 1998 WL 657722, at *2; *Lawrence*, 833 F.2d at 1161-62. Such a challenge, these courts have recognized, implicates "the *content* of the contracts, not their *existence*." *Bess*, 294 F.3d at 1305 (emphasis in original); *see also Burden*, 267 F.3d at 490 (challenge based on illegality of underlying contract involves "the substance, rather than the existence" of that contract). Whether the underlying contract is deemed voidable or void as a matter of *state* law, thus, is beside the point. The only relevant question is whether, as a matter of *federal* law, the challenge implicates "the making of an agreement to arbitrate"; if not, *Prima Paint* requires the challenge to be resolved by an arbitrator, not a court, in the first instance.

The Florida Supreme Court (like the Alabama Supreme Court), however, expressly rejected that approach. According to the majority below, "[t]here is a key distinction between the claim in *Prima Paint* and the claim presently before us: in *Prima Paint*, the claim of fraud in the inducement, if true, would have rendered the underlying contract merely *voidable*," whereas the claim of illegality here, if true, would render the contract "*void* from the outset" under state law. App. 5a-6a (emphasis modified); *see also Alabama Catalog Sales*, 794 So. 2d at 314 n.2, 316-17. The majority did not explain why that distinction should make any difference under the *federal* severability analysis adopted in *Prima Paint*. Rather, the majority asserted that the distinction between voidable and void contracts was meaningful as a matter of *state* law, on the ground that "if the underlying contract is held entirely void as a matter of law, all of its provisions, including the arbitration clause, would be nullified as well." App. 6a; *see also id.* at 7a ("We conclude that Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract.").

The majority purported to find support for its decision in a line of federal appellate cases that, it alleged, "likewise distinguished *Prima Paint* and declined to extend its holding to instances where a party claims that a contract was void from its inception." App. 6a-7a (citing *Spahr v. Secco*, 330 F.3d 1266, 1272 (10th Cir. 2003); *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001); *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 110 n.9 (3d Cir. 2000); *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851, 855 (11th Cir. 1992); *Three Valleys Municipal Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1139-42 (9th Cir. 1991)); *see also Alabama Catalog Sales*, 794 So. 2d at 314 n.2, 316-17 (invoking this same line of cases). The Florida and Alabama courts' reliance on this line of federal cases, however, was misplaced. *Each* of these federal cases involved a claim that the plaintiff had never assented to the underlying contract in the first place, either because of a signatory's lack of authority (*Sphere Drake*, *Sandvik*, *Chastain*, *Three Valleys*), or mental incapacity (*Spahr*). Such claims, these courts held, *do* implicate "the making of the agreement for arbitration" within the meaning of *Prima Paint*, on the theory that if a signatory did not assent to the underlying contract in the first place, then the signatory did not assent to arbitration. Assuming that all of these cases were correctly decided, *but see Primerica Life Ins. Co. v. Brown*, 304 F.3d 469, 472-73 (5th Cir. 2002) (holding, in direct conflict with *Spahr*, that arbitrator is to decide a mental capacity defense that does not relate specifically to the arbitration agreement), the fact remains that *none* of these cases involved a challenge to the underlying contract based on illegality—which, of course, goes to the *substance* of the parties' agreement, not its *making*.

Indeed, as noted above, the federal appellate cases that *have* involved challenges based on the alleged illegality of the underlying contract (as opposed to the arbitration agreement) have uniformly concluded that such challenges do *not* implicate "the making of the agreement for arbitration" within the

meaning of *Prima Paint*, and thus must be resolved by the arbitrator in the first instance. *See Jenkins*, __ F.3d at __, 2005 WL 388269, at *11-13; *Bess*, 294 F.3d at 1304-06; *Snowden*, 290 F.3d at 636-38; *Burden*, 267 F.3d at 489-90; *Harter*, 220 F.3d at 550; *3H & Assocs.*, 1998 WL 657722, at *2; *Lawrence*, 833 F.2d at 1161-62. Several of these cases have expressly distinguished the foregoing cases involving assent on precisely this ground. *See, e.g., Bess*, 294 F.3d at 1306 ("None of the decisions cited ... from our sister circuits counsels a different conclusion [because] all of those cases involved questions of assent to the general contract."); *Snowden*, 290 F.3d at 637 ("[A]llegations of usurious rates of interest" neither "relate specifically to the Arbitration Agreement" nor "underlie a claim that [the party resisting arbitration] failed to assent to the terms of" the underlying contract); *Burden*, 267 F.3d at 490 ("[U]nlike the *Three Valleys* line of cases, Plaintiffs['] allegations ... do not concern their failure to assent to the [underlying contracts], and do not concern signatory power.").

In short, the cases on which the Florida and Alabama Supreme Courts relied are plainly inapposite, and have been distinguished in cases (like this one) involving claims that the underlying contract was void for illegality. Justice Cantero, dissenting below (like Justices See and Lyons, dissenting in the Alabama case), got the point exactly right: "the distinction in the cases is not between voidable contracts (which are arbitrable) and void contracts (which are not)," but rather "between contracts to which the plaintiff admittedly assented, but now claims are *either* void or voidable, and contracts to which the plaintiff gave no assent." App. 23a (dissenting opinion; emphasis in original); *see also Alabama Catalog Sales*, 794 So. 2d at 318 (See, J., dissenting) ("This case is unlike ... *Three Valleys* because [the plaintiff] admits that she signed the arbitration agreement."); *id.* at 320 (Lyons, J., dissenting) ("[The plaintiff's] contention that the contract is invalid [as usurious and hence illegal] is not grounded on a claim of want

of assent, but rather on a claim on unenforceability notwithstanding assent. Such a claim must be determined by the arbitrator, not the court."). Because respondents here "do[] not dispute that [they] assented to the arbitration agreement," App. 12a (Bell, J., specially concurring), the line of cases dealing with assent is simply not implicated, *see also* App. 23a ("[Respondents] do not allege that no contract was formed. They admit assenting to both the arbitration agreements and the underlying contracts.") (Cantero, J., dissenting); App. 32a ("Here, [respondents] did not argue that they did not enter into the arbitration agreement, nor did they challenge the validity of the terms of the arbitration agreement.").

The Florida and Alabama Supreme Courts' position that, as a matter of state law, a void contract never existed thus misses the point. As the Fifth Circuit has explained, "[t]he flaw in that [position] is that the legality of the contract has not yet been decided." *Lawrence*, 833 F.2d at 1162; *see also Alabama Catalog Sales*, 794 So. 2d at 318 (See, J., dissenting) ("We cannot know whether [the plaintiff's] contracts with the defendants are void under [Alabama law] until it has been determined that, as a fact, the defendants, in connection with those contracts, charged her more interest than is allowed by law."). The whole issue, as Justice Cantero observed in his dissent below, "is *who decides* whether the contract is void—the arbitrator, as provided in the contract itself, or the court." App. 13a. And, as noted above, *Prima Paint* answered that question: as a matter of federal law, the arbitrators resolve a challenge to the validity of the underlying contract where, as here, "the making of the agreement for arbitration ... is not in issue." Indeed, the Florida and Alabama Supreme Courts embraced the very reasoning advanced by Justice Black in his *Prima Paint* dissent, and *rejected* by this Court: "If the contract was procured by fraud, then, unless the defrauded party elects to affirm it, *there is absolutely no contract, nothing to be arbitrated*." 388 U.S. at 412 (dissenting opinion; emphasis

added). Again, the dispositive point is not whether a challenge would render the underlying contract voidable or void as a matter of *state* law, but whether that challenge implicates "the making of the agreement for arbitration" as a matter of *federal* law.

The Florida Supreme Court majority could not, and did not, deny that its holding was flatly inconsistent with federal appellate precedent. Rather, the majority purported to distinguish the Eleventh Circuit's decision in *Bess* (the only on-point federal appellate authority that the majority even acknowledged) on the ground that "*Bess* was expressly resolved under federal law, not state law principles." App. 7a. That purported "distinction," however, only underscores the depth of the conflict.

It is true that *Bess* was resolved under federal law, *see* 294 F.3d at 1306 n.3, but that is because it has been established since *Prima Paint* that the severability of an arbitration clause is a matter of substantive federal law under the FAA. Indeed, as noted above, this Court granted *certiorari* in *Prima Paint* to resolve that precise issue, and squarely held that the severability analysis is governed by federal, not state, law. *See* 388 U.S. at 402-04. Accordingly, to the extent the Florida Supreme Court majority purported to rest its decision on state-law grounds, it squarely contradicted not only *Bess*, but *Prima Paint* itself. The Florida Supreme Court majority's purported "distinction" of *Bess* is thus illusory, since *Bess* specifically rejected the precise basis for that purported "distinction." *See* 294 F.3d at 1306 n.3 (refusing to follow *Alabama Catalog Sales* because "we are not deciding questions of Alabama contract law; rather, we are deciding the scope of the district court's authority under [the FAA], a question of federal law"); *see also* App. 18a (Cantero, J., dissenting) (Florida Supreme Court majority's purported distinction of *Bess* is "blatantly wrong," because "[t]he identical situation exists here": "[j]ust as the Eleventh Circuit did not

decide questions of Alabama law, we are not deciding questions of Florida law."); App. 9a (Bell, J., specially concurring) ("I agree with Justice Cantero that the issue before us is one of federal law."). Needless to say, a state court cannot avoid review on a question of federal law by simply denying that it is a question of federal law in the first place. Whether the question is one of state or federal law *itself* presents a federal question, and here that question was conclusively resolved by this Court in *Prima Paint*.

Accordingly, this petition presents a direct conflict between the highest courts of two states (Florida and Alabama), on the one hand, and six federal courts of appeals (the Fourth, Fifth, Sixth, Seventh, Ninth, and Eleventh Circuits), on the other, on an important and recurring question of federal law. The time is ripe for this Court to resolve that conflict. Indeed, as Justice Bell emphasized in his special concurrence below, state courts "are not bound" by the decisions of intermediate federal appellate courts on matters on federal law, and "[u]ntil the United States Supreme Court resolves the issue, we must independently consider the federal question for ourselves." App. 9a. This Court should now "resolve[] the issue," *id.*, to prevent further wasteful litigation about the appropriate forum in which to resolve a claim of illegality in the first instance.

Allowing this conflict to fester, moreover, not only would promote forum-shopping (especially because litigants in Florida and Alabama will receive a different result on this federal question in federal and state court), but would undermine the whole purpose of arbitration in the first place: to promote speedy and efficient resolution of disputes. *See, e.g., Southland*, 465 U.S. at 7 (noting that "prolonged litigation" is "one of the very risks the parties, by contracting for arbitration, sought to eliminate"). An arbitration agreement is effectively worthless if it will be enforced in some courts but not others. Indeed, the Florida and Alabama Supreme Courts' approach

essentially writes arbitration agreements out of contracts subject to unproven claims of illegality, since—by definition—a court's resolution of such claims would leave nothing to be decided by an arbitrator. The bottom line is that there is simply no reason, other than discredited hostility to arbitration (the very hostility the FAA was enacted to address), to assume that an arbitrator is any less able than a court to resolve a challenge to the legality of a contract. *See* App. 26a ("[T]he majority opinion evince[s] a basic distrust of arbitration and place[s] the court as jealous guardian of the determination of legal issues.") (Cantero, J., dissenting).

Enforcing the FAA by sending disputes to arbitration where, as here, they do not implicate "the making of the agreement for arbitration," vindicates "the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint*, 388 U.S. at 404. The time has come for this Court to vindicate that purpose, and the federal arbitration rights conferred by the FAA, once again.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for writ of *certiorari*.

Respectfully submitted,

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March 21, 2005

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Supreme Court of Florida

No. SC02-2161

JOHN CARDEGNA, et al.,
Petitioners,
v.
BUCKEYE CHECK CASHING, INC.,
Respondent.

[January 20, 2005]

ANSTEAD, J.

We have for review *Buckeye Check Cashing, Inc. v. Cardegna*, 824 So. 2d 228 (Fla. 4th DCA 2002), which expressly and directly conflicts with the decision in *FastFunding the Company, Inc. v. Betts*, 758 So. 2d 1143 (Fla. 5th DCA 2000). We have jurisdiction. *See* art. V, 3(b)(3), Fla. Const. For the reasons expressed below, we quash the decision of the Fourth District Court of Appeal in *Buckeye*, and approve the decision of the Fifth District Court of Appeal in *FastFunding*. We hold that an arbitration provision contained in a contract which is void under Florida law cannot be separately enforced while there is a claim pending in a Florida trial court that the contract containing the arbitration provision is itself illegal and void ab initio.

FACTUAL BACKGROUND

The relevant facts in *Buckeye* are summarized by the district court's opinion:

> Appellant, Buckeye Check Cashing, Inc., timely appeals from an order that denied its motion to

compel arbitration and to stay proceedings. We reverse and remand.

Appellees brought a class action lawsuit against Appellant. They alleged that Appellant made illegal usurious loans disguised as check cashing transactions in violation of various Florida Statutes. In response, Appellant filed a motion to compel arbitration and to stay proceedings, pursuant to the provisions for arbitration contained in the deferred deposit and disclosure agreement signed by Appellees. The agreement provided in pertinent part:

> Arbitration provisions. Any claim, dispute, or controversy (whether in contract, tort or otherwise, whether pre-existing, present, or future, and including statutory, common law, intentional tort, and equitable claims) arising from or relating to this Agreement ... or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement (collectively "Claim"), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision.... This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16.
>
> Appellees filed a memorandum in opposition to Appellant's motion to compel arbitration in which they argued that the arbitration agreement should not be enforced because it is contained in an illegal usurious contract and is, therefore, void ab initio.

Buckeye, 824 So. 2d at 229. The district court continued:

> The trial court denied Appellant's motion to compel arbitration, relying on *Party Yards, Inc. v. Templeton*, 751 So. 2d 121 (Fla. 5th DCA 2000), and *FastFunding v. Betts*, 758 So. 2d 1143 (Fla. 5th DCA 2000). Appellant contends the Federal Arbitration Act applies and that the trial court erred when it failed to construe the arbitration provision in a manner consistent with *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), and its progeny. Appellant also contends the trial court misplaced its reliance on *Party Yards* and *FastFunding*. We agree.

Buckeye, 824 So. 2d at 229-30. The Fourth District reversed the trial court's decision and held that Cardegna's challenge to the underlying contract's validity must be resolved by an arbitrator, not a trial court.

ANALYSIS

The petitioners claim that the Fourth District's holding in *Buckeye* conflicts with the Fifth District's decision in *FastFunding*, holding that arbitration could not be compelled under a contract that would be void under Florida law and that the issue of the contract's legality must be determined in Florida's courts.

FastFunding

In *FastFunding*, FastFunding the Company, Inc., appealed a trial court's order that denied FastFunding's motion to compel arbitration. *See FastFunding*, 758 So. 2d at 1143. The complaint asserted that "under the guise of a payment instrument sale," FastFunding compelled the payment of unconscionable, usurious interest rates on check cashing loans, in violation of various Florida statutes. *Id.* at 1144. Pursuant to the arbitration clause of the contract, FastFunding moved to compel arbitration. *Id.* FastFunding's motion was denied by the trial court. *Id.*

FastFunding appealed the trial court's ruling to the Fifth District Court of Appeal, which, consistent with its recent decision in a similar case, held that the trial court properly denied FastFunding's motion to compel arbitration. The district court reasoned: "If Ms. Betts is correct in her complaint that the contract violates the usury laws, then the contract is illegal and an arbitrator could not require Ms. Betts to perform under the contract. Pursuant to *Party Yards, Inc.*, the trial court was correct in refusing to order the parties to arbitrate Ms. Betts' claims." *FastFunding*, 758 So. 2d at 1144.

In the earlier decision, *Party Yards, Inc. v. Templeton*, 751 So. 2d 121 (Fla. 5th DCA 2000), the district court held that "[w]here the facts alleged by the plaintiff are sufficient to put the making of a lawful agreement at issue, the trial court must determine the validity of the agreement before compelling a party to submit to arbitration." *Id.* at 124. Judge Sharp, writing for the district court, reasoned:

> A court's failure to first determine whether the contract violates Florida's usury laws could breathe life into a contract that not only violates state law, but also is criminal in nature, by use of an arbitration provision. This would lead to an absurd result. Legal authorities from the earliest time have unanimously held that no court will lend its assistance in any way towards carrying out the terms of an illegal contract. Illegal promises will not be enforced in cases controlled by federal law.

Id. at 123 (citation omitted). Thus, the Fifth District concluded: "A party who alleges and offers colorable evidence that a contract is illegal cannot be compelled to arbitrate the threshold issue of the *existence* of the agreement to arbitrate; only a court can make that determination." *Id.* at 123-24. We agree with Judge Sharp's reasoning and analysis.

Prima Paint

Buckeye asserts that the U.S. Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), supports the Fourth District's decision and requires that an arbitrator resolve Cardegna's illegality claim, because the parties agreed in the contract to be governed by the Federal Arbitration Act and the cases applying the Act.

In *Prima Paint*, the Supreme Court resolved the issue of "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." *Id.* at 402. Having acknowledged that various courts have differed in their approach to resolving this question, the Court agreed with the approach of the Second Circuit Court of Appeals that the arbitration clause contained in a contract may be severable from the contract itself, and that "where no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud." *Id.* at 402. In so holding, the Court looked to the express language of the United States Arbitration Act (now known as the Federal Arbitration Act (FAA)), which required a federal court to order arbitration to proceed if it determined that the making of the arbitration agreement itself or failure to comply with the arbitration agreement was not in issue. *See Prima Paint*, 388 U.S. at 402. The Court reasoned that this requirement reflected the intent of Congress to provide a speedy remedy for parties who elected to resolve disputes via arbitration. *Id.* at 404.

However, we conclude that the rationale of *Prima Paint* should not be extended to the facts of this case. There is a key distinction between the claim in *Prima Paint* and the claim presently before us: in *Prima Paint*, the claim of fraud in the inducement, if true, would have rendered the underlying contract merely *voidable*. In the case before us today, however,

the underlying contract at issue would be rendered void from the outset if it were determined that the contract indeed violated Florida's usury laws. Therefore, if the underlying contract is held entirely void as a matter of law, all of its provisions, including the arbitration clause, would be nullified as well.

Appellate courts in other states have also distinguished *Prima Paint* and reached conclusions similar to those of the Fifth District in *FastFunding* and *Party Yards, Inc.* *See Rosenthal v. Great Western Fin. Sec. Corp.*, 14 Cal. 4th 394, 926 P.2d 1061, 1074 (Cal. 1996) (stating that contracts that render an agreement void ab initio are not arbitrable); *R.P.T. of Aspen, Inc. v. Innovative Communications, Inc.*, 917 P.2d 340, 342 (Colo. Ct. App. 1996) (stating that "if a party asserts that the entire contract is *illegal*, the court must determine this threshold issue"). A number of federal courts have likewise distinguished *Prima Paint* and declined to extend its holding to instances where a party claims that a contract was void from its inception. *See Spahr v. Secco*, 330 F.3d 1266, 1272 (10th Cir. 2003) (holding "that the rule announced in *Prima Paint* does not extend to a case where a party challenges a contract on the basis that the party lacked the mental capacity to enter into a contract"); *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001) (concluding that "as arbitration depends on a valid contract an argument that the contract does not exist can't logically be resolved by the arbitrator"); *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 110 n. 9 (3d Cir. 2000) (stating that *Prima Paint's* "holding dealt strictly with fraud in the inducement of the larger contract and made no broader pronouncements regarding 'void' agreements"); *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851, 855 (11th Cir. 1992) (stating that "*Prima Paint* has never been extended to require arbitrators to adjudicate a party's contention, supported by substantial evidence, that a contract *never existed at all*"); *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136 (9th Cir. 1991) (limiting *Prima Paint* to voidable contracts and

holding that a challenge to a signatory's authority to bind plaintiffs to an agreement must be resolved by a trial court). We agree with the reasoning of these cases distinguishing *Prima Paint*.

We acknowledge that recently, under similar facts, the Eleventh Circuit Court of Appeals rejected the argument that a contract's legality was to be determined by a trial court, not an arbitrator. *See Bess v. Check Express*, 294 F.3d 1298 (11th Cir. 2002). In that case, the plaintiffs also challenged the legality of a check cashing contract's arbitration clause. The Eleventh Circuit held that because there was no dispute about the plaintiffs' assent to the contract itself, the contract was presumptively valid, and any disputes, including those about the validity of the contract, were to be determined by an arbitrator. *Id.* at 1305. However, the case presently before us is distinguishable because *Bess* was expressly resolved under federal law, not state law principles. The court said: "In reaching our decision, however, *we are not deciding questions of Alabama contract law*; rather, we are deciding the scope of the district court's authority under 9 U.S.C. 4, a question of federal law." *Bess*, 294 F.3d at 1306 n. 3 (emphasis supplied).

We conclude that Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract. Florida's law has long held that contracts which are determined to be against public policy and void should not be enforced. "A contract which violates a provision of the constitution or a statute is void and illegal and will not be enforced in our courts." *Harris v. Gonzalez*, 789 So. 2d 405, 409 (Fla. 4th DCA 2001). This Court itself long ago declared:

> The inherent and inalienable right of every man to enter into contracts or refuse so to contract is not only recognized but well established. Competent persons have the utmost liberty of contracting and

> when these agreements are shown to be voluntarily and freely made and entered into, then the courts usually will uphold and enforce them. The general right to contract is subject to the limitation that the agreement must not violate the Federal or State Constitutions or state statutes or ordinances of a city or town or some rule of the common law.

Wechsler v. Novak, 26 So. 2d 884, 887 (Fla. 1946). As others have also noted, "Contracts in violation of statutory prohibitions are void, and issues arising under such contracts are therefore not arbitrable." *R.P.T.*, 917 P.2d at 342 (citing 2 Martin Domke, *Commercial Arbitration* 8.06 (rev. ed.1995)).

In other words, there are no severable, or salvageable, parts of a contract found illegal and void under Florida law. Judge Sharp's observation in *Party Yards, Inc.*, that a contrary holding would lead to an absurd result is right on point. We do not believe federal arbitration law was ever intended to be used as a means of overruling state substantive law on the legality of contracts.

CONCLUSION

Accordingly, we hold that where a party sufficiently alleges that a contract is void for violation of Florida's usury laws, the Florida courts, and not an arbitrator, must first determine the contract's legality before a party may be required to submit to arbitration under a provision of the contract. Hence, Cardegna's claim that the underlying check cashing contract is illegal and void ab initio as being usurious must be resolved by a trial court before arbitration of any other disputes may be compelled. We approve the Fifth District's opinions in *FastFunding* and *Party Yards, Inc.*, and we quash and remand *Buckeye* for further proceedings consistent with this opinion.

It is so ordered.

WELLS, LEWIS, QUINCE, and BELL, JJ., concur.

BELL, J., concurs specially with an opinion.

CANTERO, J., dissents with an opinion.

PARIENTE, C.J., recused.

BELL, J., specially concurring.

I agree with Justice Cantero that the issue before us is one of federal law, and in that respect I agree that the decisions of federal courts of appeals should be considered as persuasive authority on the issue. But I do not agree with the conclusion reached by Justice Cantero or the federal decisions on which he relies. Although we should carefully consider the decisions of intermediate-level federal courts on issues of federal law, we are not bound by such decisions. Until the United States Supreme Court resolves the issue, we must independently consider the federal question for ourselves. Because I disagree with the conclusions that have been reached by the federal courts cited by Justice Cantero, I join the majority's decision.

I.

I will begin by briefly restating the issue. The petitioners (hereinafter referred to collectively as "Cardegna," the named petitioner) entered into numerous check-cashing transactions (also known as "payday loans") with Buckeye Check Cashing. Cardegna brought a class action (on behalf of himself and those similarly situated) in which he argues that these check-cashing transactions were actually nothing other than usurious loans under Florida law, which would make the check-cashing contracts void ab initio and unenforceable. Buckeye sought to stay the trial court proceedings and compel arbitration of Cardegna's claims pursuant to the arbitration clause contained in the check-cashing contracts. The arbitration clause provided that

> [a]ny claim, dispute, or controversy (whether in contract, tort or otherwise ... including statutory, common law, intentional tort, and equitable claims)

> arising from or relating to this [check-cashing] Agreement ... or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement ... shall be resolved ... by binding arbitration pursuant to this Arbitration Provision.

Buckeye Check Cashing, Inc. v. Cardegna, 824 So. 2d 228, 229 (Fla. 4th DCA 2002).

It is also important to note that Cardegna does not claim that the arbitration clause itself (separately, as opposed to the contract as a whole) somehow is invalid. His claim, rather, is that the contract in its entirety is invalid and unenforceable because the check-cashing transaction underlying the contract was illegal. That issue—whether the check-cashing transaction is illegal—has not yet been decided. Indeed, the issue before us here is who will (or must) decide that issue: a court or an arbitrator. The issue, in other words, is whether the trial court was bound to enforce the arbitration clause and required to compel arbitration of Cardegna's claims. The majority holds that it was not, and I agree.

II.

To explain why I agree with the majority that the trial court was not required to enforce the arbitration clause and compel arbitration of Cardegna's claims, I begin with the language of the Federal Arbitration Act (FAA). The FAA provides that

> [a] written provision in any ... contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (2000). Essentially, the FAA requires that an arbitration clause be treated in the same manner as any other

contractual provision: Legislatures cannot create rules, and courts cannot apply rules, that discriminate against or give a less-favored status to arbitration clauses. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 10-11 (1984). The FAA does not require, however, that state courts treat arbitration clauses more favorably than they would treat any other contractual provisions. *See Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995) ("[By passing the FAA, Congress] intended courts to enforce arbitration agreements into which parties had entered, and to place such agreements upon the same footing as other contracts.") (internal brackets, quotation marks, and citations omitted).

I believe the decisions cited by Justice Cantero go too far towards treating arbitration clauses as a class of "super" clauses, immune from a state's otherwise generally applicable contract law. I do not believe the FAA was intended to preempt a state's generally applicable consumer protection laws (as opposed to laws directed specifically at the validity or enforceability of arbitration clauses, either in general or in certain types of contracts, *see, e.g., Southland Corp.*, 465 U.S. at 10), and to require the arbitration of the very legality of the underlying contract (of which the arbitration clause was a part) under a state's usury laws. The state's regulatory authority in the consumer protection arena could be severely weakened if predatory lenders are allowed to circumvent the state courts and direct to arbitration claims that their lending practices violate state law. *See* Joshua R. Welsh, Comment, *Has Expansion of the Federal Arbitration Act Gone Too Far?: Enforcing Arbitration Clauses in Void Ab Initio Contracts*, 86 Marq. L. Rev. 581, 610 (2002).

If the transactions at issue here are determined by a state court not to be illegal per se, then of course any particular claims or disputes arising out of the transactions would presumably be referable to arbitration. But the question here is whether there even was an agreement to arbitrate—an

enforceable agreement to arbitrate. "The FAA directs courts to place arbitration agreements on equal footing with other contracts, but it 'does not require parties to arbitrate when they have not agreed to do so.'" *Equal Employment Opportunity Comm'n v. Waffle House, Inc.*, 534 U.S. 279, 293 (2002) (quoting *Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)). Whether a valid and enforceable arbitration agreement exists is a threshold question that must be answered by the courts, and it must be answered by reference to the state's generally applicable contract law.[1] Cardegna does not dispute that he assented to the arbitration agreement; but assent alone does not make for a valid and enforceable contract. There is more to "the making of the arbitration agreement," dissenting op. at [17a], than mutual assent. By examining arbitration clauses only for "assent," Justice Cantero's (and the federal circuit courts') approach does not simply treat arbitration clauses "separate[ly]" or "independently," dissenting op. at [20a], but *differently*.

The issue of the underlying contract's legality must be determined by the courts before any claim or dispute arising out of the contract may be referred to arbitration pursuant to the contract's arbitration clause—not because we are applying a more stringent standard to the enforceability of the arbitration clause (a course of action that would violate the FAA), but because we are, as the FAA allows, applying the generally applicable "grounds as exist at law or in equity for the

[1] There is, of course, a somewhat troubling "circularity" to this reasoning. After all, we do not yet know if the check-cashing transactions are illegal under Florida law, so we do not know if the contract here really was void ab initio. Yet the dissenting position itself rests on a sort of circular reasoning. The dissent would compel the arbitration of the legality claim on the ground that until that claim is resolved, there are no grounds for invalidating the arbitration clause. But if the arbitrator were to conclude that the contracts were illegal and unenforceable, we then would have enforced an unenforceable contract.

revocation of any contract." 9 U.S.C. § 2. If, under Florida law, no contract ever existed here, then by definition no enforceable agreement to arbitrate ever existed. The dissenting opinion and the federal decisions on which it relies have elevated arbitration clauses to a more favored status, exempting them from the state's otherwise generally applicable contract law. The FAA, however, mandates only that arbitration clauses be given equal status. In this case, if a valid and enforceable contract exists, then a valid and enforceable arbitration clause exists. The problem is that we do not yet know if a valid and enforceable contract exists. I therefore concur in the majority's decision.

CANTERO, J., dissenting.

The issue in this case is not whether a check-cashing contract is void as usurious. That issue will be determined under Florida law. The issue here is *who decides* whether the contract is void—the arbitrator, as provided in the contract itself, or the court. That issue must be decided under federal law, specifically the Federal Arbitration Act. The majority confuses these issues. The majority also disregards the plain language of the Federal Arbitration Act, fails correctly to apply the United States Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), and either ignores or fails to distinguish the federal cases compelling arbitration in identical circumstances. I respectfully dissent.

I. The FAA and *Prima Paint*

Contrary to the majority's assumption, the issue in this case arises under federal, not Florida, law. As no one disputes, the arbitration agreement itself provides that it "is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16." The parties concede they are governed by the FAA.

Any discussion of the arbitrability of the parties' dispute should therefore begin with the plain language of the FAA—language conspicuously absent from the majority opinion. Section 2 of the FAA provides that an agreement to arbitrate "in any maritime transaction or a contract evidencing a transaction involving commerce ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2000). Section 4 of the FAA provides in pertinent part as follows:

> The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement .... If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

9 U.S.C. § 4 (2000) (emphasis added). Therefore, as many courts have recognized, under the FAA the issue for a court confronted with a plaintiff seeking to avoid arbitration is whether the plaintiff is contesting the making of the arbitration agreement or the underlying contract.

Given the parties' agreement to be governed by the FAA, the district court in this case correctly recognized its task as simply to apply controlling federal law to the case at hand. *See Buckeye Check Cashing, Inc. v. Cardegna*, 824 So. 2d 228, 230 (Fla. 4th DCA 2002); *see also Jensen v. Rice*, 809 So. 2d 895, 899 (Fla. 3d DCA 2002) (recognizing that the FAA "supersedes inconsistent state law" and "[a]s a result, Florida courts must enforce arbitration agreements that are valid and enforceable under the [FAA], even where, as here, the arbitration agreement would not be enforceable under Florida law").

Federal law favors arbitration. As the United States Supreme Court has recognized, the purpose of the FAA is to override the judiciary's reluctance to enforce arbitration agreements. *See Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989). The FAA places such agreements on the same footing as other contracts. *Id.* "The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Mem. Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983). Under the FAA, questions of arbitrability "must be resolved with a healthy regard for the federal policy favoring arbitration," even when general state law principles of contract interpretation are applied. *Volt Info. Scis.*, 489 U.S. at 475-76. "The [FAA] establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone*, 460 U.S. at 24-25.

In concluding that the check-cashing agreement's enforceability should be decided in arbitration, the district court relied in part on *Prima Paint*, where the United States Supreme Court addressed "whether the federal court or an arbitrator is to resolve a claim of 'fraud in the inducement,' under a contract governed by the [FAA]." 388 U.S. at 396-97; *see* 824 So. 2d at 230. Citing to section 4 of the Act (quoted above), which requires arbitration to go forward if "the making of the agreement for arbitration or the failure to comply therewith is not in issue," the Court concluded that the statute itself answers the question. 388 U.S. at 403. That is, "the statutory language does not permit the federal court to consider claims of fraud in the inducement *of the contract generally*." *Id.* at 404 (emphasis added). The Court held that a court *may* adjudicate a claim of "fraud in the inducement of the arbitration clause itself," *id.* at

403-04, because then the issue is the "making" of the *arbitration* agreement. Thus, a court "may consider *only* issues relating to the making and performance *of the agreement to arbitrate*." *Id.* at 404 (emphasis added). As the Court stated:

> Accordingly, if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the "making" of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.... *We hold, therefore, that in passing upon a § 3 application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate.*

Id. at 403-04 (footnote omitted) (emphasis added).

Applying these principles, the Court held that because the fraud claim did not specifically address the arbitration agreement and the arbitration clause was sufficiently broad to encompass the dispute, including "legal" issues, the parties must proceed to arbitration. *Id.* at 406-07.

The import of *Prima Paint*, then, is that under the FAA, arbitration agreements or arbitration clauses contained in contracts are treated separately from the underlying contracts. The FAA expressly limits courts to determining whether the making of the arbitration agreement itself—not the underlying contract—is disputed. The only exception, as explained later, is where a party contests its very assent to the underlying contract, and therefore to the arbitration agreement as well.

The majority violates the FAA's express directive. It dismisses *Prima Paint* as applicable only to voidable—as opposed to void—contracts. Nothing in that opinion makes that distinction, and even though the issue in that case involved a voidable contract—it was allegedly fraudulently induced—the

Court did not limit its holding. *Cf. Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 110 n. 9 (3d Cir. 2000) (noting that the dissenting opinion in *Prima Paint* "impl [ies] that the majority rejected the void/voidable distinction"). Nor can its holding logically be limited to such contracts because the Court interpreted the plain language of the FAA, which does not exempt from arbitration allegations that the underlying contract is void. The Court did acknowledge a distinction—apparent in the statute itself—but not between void and voidable contracts. Such a distinction is arbitrary and totally disconnected from the statutory language. Rather, the Court distinguished between issues concerning the making of the underlying contract, which are arbitrable, and issues concerning the making of the arbitration agreement, which are not.

II. Federal Appellate Cases on Point

In the last three years no fewer than three federal courts of appeals have decided the precise issue we confront today—whether, under the FAA, the issue of whether a check-cashing transaction is void as usurious is for the court or the arbitrator to decide. *Every one* unanimously has held that the issue is one for the arbitrators. Nevertheless, the majority fails to distinguish one of them and simply ignores the others.

Most recently, the Eleventh Circuit Court of Appeals decided this issue. In *Bess v. Check Express*, 294 F.3d 1298, 1304 (11th Cir. 2002), the plaintiffs had signed deferred payment transactions containing arbitration agreements governed by the FAA. They filed a class action suit against Check Express, alleging that the transactions constituted usurious loans under state law. *Id.* at 1301-02. When Check Express invoked the arbitration clause, the plaintiffs contended that the court, not an arbitrator, must decide the legal question of whether the transactions were void as usurious. The court recognized that its task was not to determine the legality of the contract, but simply to address the threshold question of who should decide

the issue, the arbitrator or the court. *Id.* at 1304. Noting that the FAA limits courts to the issue of the "making of the arbitration agreement," the court concluded that it must determine whether the allegation that the underlying contract was illegal placed at issue *the making of the arbitration agreement*. *Id.* The court emphasized that the plaintiffs did not dispute having assented to the underlying contracts. The court thus concluded that the question of the legality of the contract was for the arbitrator because the case fell "within the 'normal circumstances' ... where the parties have signed a presumptively valid agreement to arbitrate any disputes, including those about the validity of the underlying transaction." *Id.* at 1306 (citing *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851, 854 (11th Cir. 1992)).

The majority acknowledges *Bess*, but distinguishes it on the purported ground that the federal court was deciding an issue of federal law, while this Court is deciding an issue of state law. Majority op. at [7a-8a]. That conclusion is blatantly wrong.

The majority cites a footnote in which the Eleventh Circuit stated the following in pertinent part:

> Colburn contends that we are bound by Alabama law in deciding defenses to the arbitration agreement, and therefore, [Alabama case law] requires that the void *ab initio* argument be decided by the court. In reaching our decision, however, we are not deciding questions of Alabama contract law; rather we are deciding the scope of the district court's authority under [the FAA], a question of federal law.

Id. at 1306 n.3.

The identical situation exists here. Just as the Eleventh Circuit did not decide questions of Alabama law, we are not deciding questions of Florida law. Specifically, we are *not* deciding whether the check-cashing contract is usurious. The

sole issue before *both* courts is the same: *who decides* the legality of the underlying contract? The issue here, as in *Bess*, is one of federal law because the FAA governs the arbitration agreement. *Bess* cannot be distinguished.

The Fourth Circuit Court of Appeals also has addressed the precise claim presented here. In *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 636 (4th Cir. 2002), *cert. denied*, 537 U.S. 1087 (2002), the court considered whether the plaintiff's contention that a "deferred deposit transaction," such as the one in this case, was a usurious loan void under Maryland law was subject to arbitration. Noting that the plaintiff did not dispute that the FAA governed the arbitration agreement or that her claim fell within the scope of the arbitration agreement, the court applied *Prima Paint* and the FAA's requirement that the party contesting arbitration must allege grounds relating to the arbitration clause, not the underlying contract. *Id.* at 636. The court concluded that under the severability doctrine of *Prima Paint*, arbitration must proceed because the plaintiff's "allegations of usurious rates of interest ... d[id] not relate specifically to the Arbitration Agreement [nor did] they underlie a claim that [the plaintiff] failed to assent to the terms of the ... Agreement." *Id.* at 637.

Finally, in *Burden v. Check Into Cash of Kentucky, LLC*, 267 F.3d 483, 486-87 (6th Cir. 2001), *cert. denied*, 535 U.S. 970 (2002), the plaintiffs also alleged that the check cashing agreements they signed were usurious in violation of state law and therefore void. The court concluded that because the plaintiffs admitted assenting to the agreements, the challenge to the legality of the underlying contract constituted a "challenge [to] the substance, rather than the existence, of the loan agreements." *Id.* at 490; *accord Furgason v. McKenzie Check Advance of Indiana Inc.*, No. IP00-121-C H/G, 2001 WL 238129 (S.D. Ind. Jan. 3, 2001) (holding that a plaintiff cannot avoid arbitration by alleging or showing the illegality of a so-called payday loan contract); *see also Sweet Dreams Unlimited,*

Inc. v. Dial-A-Mattress Int'l, Ltd., 1 F.3d 639, 642 (7th Cir. 1993) (holding that under *Prima Paint* the claim that the underlying contract should be rescinded because it violated state law was subject to arbitration under the broad scope of the contract's arbitration clause).

We should follow *Bess*, *Snowden*, and *Burden*, which considered the identical issue under identical facts and held that, under the plain language of the FAA, the issue of whether a check-cashing transaction is usurious must be determined by the arbitrators. These decisions are persuasive on matters of federal law. *See State v. Dwyer*, 332 So. 2d 333, 335 (Fla. 1976) (stating that federal court rulings are persuasive).

Justice Bell, specially concurring, agrees with me that "the issue before us is one of federal law" and that "the decisions of federal courts of appeals should be considered as persuasive authority." Concurring op. at [9a]. He is not persuaded by those decisions, however, because he thinks they "go too far towards treating arbitration clauses as a class of 'super' clauses, immune from a state's otherwise generally applicable contract law." Concurring op. at [11a]. I disagree with Justice Bell for two reasons.

First, the federal circuit courts have treated arbitration clauses not as a class of "super" clauses, but as a class of *separate* clauses—separate, that is, from the other clauses in a contract. Under the reasoning of the federal courts, arbitration clauses are not immune from state contract law. They are simply evaluated *independently* of the rest of the contract under "the state's otherwise generally applicable contract law." Concurring op. at [11a].

Second, although it is true that *Bess*, *Snowden*, and *Burden* are only persuasive, they are all based on *Prima Paint*, which is binding. All three cases reached the same conclusion on similar facts because they each found *Prima Paint* indistinguishable, as I do, and therefore controlling. *See Bess*, 294 F.3d at 1306

(stating that, under the holding of *Prima Paint*, courts may only "consider issues relating to the making and performance of the agreement to arbitrate"); *Snowden*, 290 F.3d at 637 (stating that the independent evaluation of arbitration clauses is a "rule ... derived from the Supreme Court's opinion in *Prima Paint*"); *Burden*, 267 F.3d at 490 (finding no logical distinction between *Prima Paint* and cases where a party "subsequently discover[s] that certain terms of the contract may violate state law"). The majority's reasoning contradicts not just the federal circuit court cases, but also *Prima Paint*.

III. Federal Cases Based on Different Circumstances

Instead of following the federal cases that have decided this identical issue under identical facts, the majority relies on other cases that considered different attacks on different types of contracts. In particular, the majority cites cases refusing to refer issues to arbitration. Majority op. at [6a-7a]. As the Sixth Circuit emphasized in *Burden*, 267 F.3d at 489, however, in those cases the question was *not* whether a party assented to a contract that later was alleged to violate state law. 267 F.3d at 490. Rather, in each case, the complaining party alleged that because of some defect in signatory power, no contract *ever* was formed. *See, e.g., Sandvik*, 220 F.3d at 112 (holding that where a party claimed that the signee lacked authority to bind it to the contract containing the arbitration clause, "the very existence of [the] agreement [was] disputed" and the court must resolve the threshold question of whether an arbitration agreement exists); *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co., Inc.*, 925 F.2d 1136, 1138, 1144 (9th Cir. 1991) (holding that the court, not the arbitrator, must decide whether the signatory had authority to bind the plaintiffs to contracts containing arbitration clauses); *Spahr v. Secco*, 330 F.3d 1266, 1273 (10th Cir. 2003) (holding that a claim that the signatory lacked the mental capacity to enter into the contract goes to the making of both the contract and the arbitration agreement); *Sphere Drake Ins. Ltd. v. All American Ins. Co.*, 256 F.3d 587, 590-91 (7th

Cir. 2001) ("A person whose signature was forged has never agreed to anything. Likewise with a person whose name was written on a contract by a faithless agent who lacked authority to make that commitment. This is not a defense to enforcement, as in *Prima Paint*; it is a situation in which no contract came into being[.]").

In *Bess*, the Eleventh Circuit similarly distinguished its earlier decision in *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851 (11th Cir. 1992). In *Chastain*, the plaintiff never personally signed the customer agreements at issue, and thus she contended that she was not bound by the arbitration provisions within them. 957 F.2d at 853. The court acknowledged that "parties cannot be forced to submit to arbitration if they have not agreed to do so." *Id.* at 854 (citing *Volt Info. Scis., Inc.*, 489 U.S. at 478). Thus, "[u]nder normal circumstances, an arbitration provision with a contract admittedly signed by the contractual parties is sufficient to require the district court to send any controversies to arbitration." 957 F.2d at 854. The court found the case before it to be the "rare" case in which "the very existence of *any* agreement, *including the existence of an agreement to arbitrate*" was at issue. *Id.* Under those facts, "there [wa]s no presumptively valid general contract." *Id.* If a party did not sign the underlying contract, then the party may not have agreed to arbitration. Thus, the making of the arbitration agreement *was* at issue, and under the FAA a court, not an arbitrator, should decide the question. *Id.* at 855.

In *Bess*, the Eleventh Circuit noted both the distinctive facts of *Chastain* and its narrow holding. 294 F.3d at 1305. The court explained that "the focus of the court's decision in *Chastain* ... was on the question of assent, i.e., whether the parties mutually had agreed to the contracts," and contrasted the claim before it that the deferred payment contracts violated state law:

> At bottom, Colburn challenges the *content* of the contracts, not their *existence*. Indeed, unlike the contracts in *Chastain*, both the arbitration agreement and the deferred payment contracts were signed by Colburn, and there is no question about Colburn's assent to those contracts. Thus, this case falls within the "normal circumstances" described in *Chastain, where the parties have signed a presumptively valid agreement to arbitrate any disputes, including those about the validity of the underlying transaction*. Therefore, the issue raised by Colburn—whether the deferred payment transactions are void as illegal—is one for the arbitrator, not the court.

294 F.3d at 1305-06 (emphasis added).

Thus, the distinction in the cases is not between voidable contracts (which are arbitrable) and void contracts (which are not), as the majority finds. Rather, it is between contracts to which the plaintiff admittedly assented, but now claims are *either* void or voidable, and contracts to which the plaintiff gave no assent. If no contract was formed, then the arbitration agreement, which was *part* of that contract, was not formed, either. Courts must determine this threshold issue. The plaintiffs in this case, however—and in all the cases involving check-cashing transactions—do not allege that no contract was formed. They admit assenting to both the arbitration agreements and the underlying contracts. Rather, they argue that the contracts were usurious. Therefore, the "making of the agreement for arbitration" is not at issue, and under the FAA the arbitrators, not the courts, must decide the issue.

IV. The Majority's Reliance on *Party Yards*

The majority also relies on and approves *Party Yards, Inc. v. Templeton*, 751 So. 2d 121 (Fla. 5th DCA 2000). The court in that case, however, did not have the benefit of the three federal

cases I have discussed—*Bess*, *Snowden*, and *Burden*—which are precisely on point and dictate the outcome here. Moreover, the court's analysis is based on the presumption that the contract at issue was illegal (an analysis later rebutted). *See* 751 So. 2d at 123 ("The issue here ... is whether a contract that violates state law and is criminal in nature, can be referred to arbitration.").[2] The court expressed the unwarranted fear that without a court determination of the legality of the now-presumptively illegal contract, the court "could breathe life" into an illegal contract by sending the case to arbitration. 751 So. 2d at 123. This simply is not so.

In *Lawrence v. Comprehensive Business Services Co.*, 833 F.2d 1159 (5th Cir. 1987), the Fifth Circuit rejected a similar argument. The plaintiffs claimed that their franchise agreement, which contained an arbitration clause, was illegal under Texas state law and that if the court ordered arbitration it would "'in essence ... effectuate an illegal agreement.'" *Id.* at 1162. The court noted that the "argument presumes that the contract is illegal and that presenting the dispute to the arbitrator somehow effectuates an illegal contract. The flaw in the argument is that the legality of the contract has not yet been decided." *Id.* The court also rejected the plaintiffs' claim that the issue was one of law to be decided by a court because they "d[id] not contend that the agreement did not allow the arbitrator to decide purely legal questions." *Id.* Because there was no attack on the arbitration clause itself, the court held that "*Prima Paint* requires that their claim of illegality be arbitrated pursuant to the contract." 833 F.2d at 1162. Finally, the court rejected the claim that enforcing the arbitration provision of the allegedly illegal contract would contravene state law, saying

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[2] The Fifth District has since decided that deferred payment transactions such as those involved in *Party Yards* and in this case are *not* usurious. *See Betts v. Ace Cash Express, Inc.*, 827 So. 2d 294, 297 (Fla. 5th DCA 2002).

that the "argument forgets that the arbitrability of an issue under the Federal Arbitration Act is a matter of federal law." *Id.*

Contracts are presumed valid until held to be illegal. In *National Railroad Passenger Corp. v. Consolidated Rail Corp.*, 892 F.2d 1066, 1070 (D.C. Cir. 1990), the court held it error to treat an arbitration clause as unenforceable "merely because the substantive contract *may*—if the district court is correct about public policy—*be unenforceable*." Citing the FAA's sole exception to arbitration, a "flaw in the formation of the agreement to arbitrate," the court explained its holding as follows:

> For a court to intervene before the arbitrator has determined what the contract means, and what it requires in the particular circumstances of their dispute, because he *may* determine that it requires the performance of an unlawful act, prematurely disrupts the system of private ordering upon which "public policy"—as declared in the Arbitration Act and in the Supreme Court cases liberally interpreting it—places maximum possible reliance....
>
> In sum, if parties have validly agreed to submit a dispute to arbitration, we see no reason not to enforce that agreement. If the arbitrator construes the contract so as to require someone to commit an illegal act, a court can then refuse to enforce the arbitrator's decision. A court cannot, however, bypass the arbitration process simply because a public policy issue might arise.

Id. at 1071 (emphasis added).

The majority here commits the same error as did the court in *Party Yards*. The majority holds that "an arbitration provision contained in a contract *which is void under Florida law* cannot be separately enforced while there is a claim pending in a

Florida trial court that the contract containing the arbitration provision is itself illegal and void ab initio." Majority op. at [1a] (emphasis added). Thus, the majority assumes the illegality of the contract in determining that a court should decide the legality of a contract. Under the parties' arbitration agreement, however, that issue is for the arbitrator.

Finally, the court in *Party Yards* relied on cases such as *Three Valleys*, 925 F.2d at 1136, and *Chastain*, 957 F.2d 851. As explained above, in each of these cases the parties' *assent* to the contract was at issue. Here, on the other hand—and in cases such as *Bess*, *Snowden*, and *Burden*—the parties assented both to the contracts and to the arbitration clauses.

At their heart, *Party Yards* and the majority opinion evince a basic distrust of arbitration and place the court as jealous guardian of the determination of legal issues. By endorsing *Party Yards*, the majority not only disregards controlling federal law and the federal preference for enforcing arbitration clauses, but it has created a new analysis for arbitration claims. Under the express terms of the FAA, a party opposed to arbitration must challenge the making of the arbitration agreement itself. Under the majority's reasoning, the opponent need only allege that the underlying contract violates a state statute or public policy in a way that renders it void. Because the majority's decision contradicts federal law favoring arbitration and fails to follow federal cases directly on point, I respectfully dissent.

District Court of Appeal of Florida,
Fourth District

BUCKEYE CHECK CASHING, INC.,
a foreign corporation d/b/a Checksmart,
Appellants,
v.
John A. CARDEGNA and Donna Reuter, etc., et al.,
Appellees.

No. 4D01-3549

July 24, 2002
Rehearing Denied Sept. 4, 2002

DELL, JOHN W., Senior Judge.

Appellant, Buckeye Check Cashing, Inc., timely appeals from an order that denied its motion to compel arbitration and to stay proceedings. We reverse and remand.

Appellees brought a class action lawsuit against Appellant. They alleged that Appellant made illegal usurious loans disguised as check cashing transactions in violation of various Florida Statutes. In response, Appellant filed a motion to compel arbitration and to stay proceedings, pursuant to the provisions for arbitration contained in the deferred deposit and disclosure agreement signed by Appellees. The agreement provided in pertinent part:

> *Arbitration provisions.* Any claim, dispute, or controversy (whether in contract, tort or otherwise, whether pre-existing, present, or future, and including statutory, common law, intentional tort, and equitable claims) arising from or relating to this Agreement ... or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement (collectively "Claim"), shall be

> resolved, upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision.... This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16.

Appellees filed a memorandum in opposition to Appellant's motion to compel arbitration in which they argued that the arbitration agreement should not be enforced because it is contained in an illegal usurious contract and is, therefore, void ab initio. Appellees also asserted that the arbitration clause was unconscionable. However, Appellant correctly points out that at the hearing before the trial court, Appellees did not argue that the arbitration provision was unconscionable. Accordingly, the issue of unconscionability is not properly before this court for review. *See Parlier v. Eagle-Picher Indus., Inc.*, 622 So. 2d 479 (Fla. 5th DCA 1993).

The trial court denied Appellant's motion to compel arbitration, relying on *Party Yards, Inc. v. Templeton*, 751 So. 2d 121 (Fla. 5th DCA 2000), and *FastFunding v. Betts*, 758 So. 2d 1143 (Fla. 5th DCA 2000). Appellant contends the Federal Arbitration Act applies and that the trial court erred when it failed to construe the arbitration provision in a manner consistent with *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L. Ed. 2d 1270 (1967), and its progeny. Appellant also contends the trial court misplaced its reliance on *Party Yards* and *FastFunding*. We agree.

Appellant correctly argues that federal law controls because the arbitration agreement expressly provides that "this arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act...." *See Donald & Co. Sec., Inc. v. Mid-*

Florida Cmty. Services, Inc., 620 So. 2d 192 (Fla. 2d DCA 1993).

In *Prima Paint Corp.*, 388 U.S. at 403-04, 87 S.Ct. 1801, the Supreme Court stated:

> Accordingly, if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.... We hold, therefore, that in passing upon a *§ 3* application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate.

(footnotes omitted)

In *Manning v. Interfuture Trading, Inc.*, 578 So. 2d 842 (Fla. 4th DCA 1991), this court affirmed an order compelling arbitration because the record showed that the appellant's claim of fraud in the inducement in the making of the arbitration agreement was actually based on the entire transaction rather than only the arbitration agreement. The court, in *Manning*, stated:

> In several subsequent cases the holding in *Prima Paint* has been construed as requiring that where the entire transaction is infected by the alleged fraud or other ground for avoidance, the matter should be submitted to arbitration. Put another way, a rule has been distilled from the *Prima Paint* rationale that only where the attack is specifically and exclusively directed toward the arbitration clause or a separate agreement to arbitrate may the court try the issue before submitting the balance of the controversy to arbitration....

Id. at 843 (citations omitted). *See also Spitz v. Prudential-Bache Secs., Inc.*, 502 So. 2d 479 (Fla. 4th DCA 1987).

Appellees do not challenge the validity of the arbitration provision. Rather, they contend that the underlying contract is void ab initio because it is criminally usurious and, therefore, never existed at all. They further argue that *Party Yards*[1], *FastFunding*, and *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851 (11th Cir. 1992), support the general proposition that a trial court must determine the legal validity of the underlying contract before compelling arbitration. However, *Chastain* is consistent with the Supreme Court's decision in *Prima Paint* and does not support Appellees' argument. In *Chastain*, the appellant denied that she had signed the customer agreements that contained the arbitration clauses. The court stated that

> Because on the unusual facts of this case we believe that "the making of the arbitration agreement ... [is] in issue,".... Chastain is entitled to have the district court, rather than a panel of arbitrators, determine whether or not she agreed to arbitrate her claims against Robinson-Humphrey.

Chastain, 957 F.2d at 852-53.

Appellees argue that the trial court was correct because the court in *Chastain* said, "[h]owever, if the validity of the agreement to arbitrate is in issue, a district court, not a panel of arbitrators, must decide if the arbitration clause is enforceable against the parties." *Id.* at 854. We are not persuaded by this argument. The *Chastain* court also said "[t]hus, 'the first task

[1] In *Party Yards*, the district court of appeal stated, "we find that the trial court's reliance on *Prima Paint* was misplaced because that case is inapplicable under the facts presented here. In this case, the language in the arbitration provision of the contract is not broad enough to encompass a usury violation...." Here, however, the arbitration provision expressly includes statutory claims and is broad enough to encompass a usury violation.

of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute.'" *Id.* (citation omitted). Additionally, the court noted that it

> recognizes that the *Prima Paint* doctrine has been extended to require arbitration panels to decide many issues regarding the validity of a contract containing arbitration language—including allegations that such contracts are voidable because they involved duress, undue coercion, confusion, mutual mistake, or unconscionability.

Id. at 855 (citations omitted).

In *Bess v. Check Express*, 294 F.3d 1298 (11th Cir. 2002), the court of appeals considered the use of *Chastain* as support for an argument that the underlying contract was void ab initio. The court stated:

> Likening his void *ab initio* allegations to the contentions in *Chastain* that no contract ever existed, Colburn argues that, as in *Chastain*, the court must determine the legality of the deferred payment transactions before deciding whether to compel arbitration. But the focus of the court's decision in *Chastain*, as just explained, was on the question of assent, i.e., whether the parties mutually had agreed to the contracts. By contrast, Colburn urges that the transactions in this case are void, not because he failed to assent to the essential terms of the contracts, but because those terms allegedly render the contracts illegal under Alabama law. At bottom, Colburn challenges the *content* of the contracts, not their *existence*. Indeed, unlike the contracts in *Chastain*, both the arbitration agreement and the deferred payment contracts were signed by Colburn, and there is no question about Colburn's assent to those contracts. Thus, this case

falls within the "normal circumstances" described in *Chastain*, where the parties have signed a presumptively valid agreement to arbitrate any disputes, including those about the validity of the underlying transaction. Therefore, the issue raised by Colburn—whether the deferred payment transactions are void as illegal—is one for the arbitrator, not the court. None of the decisions cited by Colburn from our sister circuits counsels a different conclusion. Like *Chastain*, all of those cases involved questions of assent to the general contract.... *See Burden v. Check Into Cash of Kentucky, LLC*, 267 F.3d 483, 489-90 (6th Cir. 2001) (concluding that plaintiffs' allegations that deferred payment contracts were void as illegal constituted challenge to substance of loan agreements and should thus be decided by arbitrator rather than by court). Because Colburn's void *ab initio* argument is an issue for the arbitrator, it does not furnish an adequate basis for denying PayDay's motion to compel arbitration.

Id. at 1305-06 (emphasis supplied in original).

Here, appellees did not argue that they did not enter into the arbitration agreement, nor did they challenge the validity of the terms of the arbitration agreement. Accordingly, we reverse the trial court's order denying appellant's motion to compel arbitration and remand this cause for further proceedings.

REVERSE AND REMANDED.

SHAHOOD and HAZOURI, JJ., concur.

IN THE CIRCUIT COURT OF
THE FIFTEENTH JUDICIAL CIRCUIT
IN AND FOR PALM BEACH COUNTY, FLORIDA

JOHN A. CARDEGNA,
and DONNA REUTER
individually and on behalf
of others similarly situated,
Plaintiffs,

CASE NO: CL 01-1162 AJ
CLASS REPRESENTATION

vs.

BUCKEYE CHECK
CASHING, INC. a foreign
corporation, dba
CHECKSMART,
BUCKEYE CHECK
CASHING OF FLORIDA,
INC. a foreign corporation
dba CHECKSMART and
UNKNOWN ENTITIES
AND INDIVIDUALS

Defendants.

ORDER DENYING DEFENDANT BUCKEYE CHECK CASHING, INC.'S MOTION TO COMPEL ARBITRATION AND STAY PROCEEDING

This cause coming before the Court on July 13, 2001 on Defendant Buckeye Check Cashing, Inc's. Motion to Compel Arbitration and Stay Proceeding and the Court having

considered the pleadings, memoranda of law and the argument of counsel, it is:

ORDERED AND ADJUDGED that based on the Fifth District Court of Appeal's decisions in *Party Yards, Inc. v. Templeton*, 751 So. 2d 121, and *Fastfunding v. Betts*, 758 So. 2d 1143, that defendants' Motion to Compel Arbitration is DENIED. The court will hold an evidentiary hearing to determine whether there can be a colorable showing that the contracts containing the arbitration provisions are void ab initio, as being usurious.

Done and Ordered in chambers at West Palm Beach, Florida this 6th day of August, 2001.

/s/
Thomas H. Barkdull, III
CIRCUIT COURT JUDGE

cc Counsel of Record

Supreme Court, U.S.
FILED
MAY 23 2005
OFFICE OF THE CLERK

(9)

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,
Petitioner,

v.

JOHN CARDEGNA, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF FLORIDA

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America ("the Chamber") is the world's largest business federation, representing an underlying membership of more than three million businesses, state and local chambers of commerce, and professional organizations. Chamber mem-

[1] Letters of consent from both parties have been filed with the Clerk of Court. Pursuant to Rule 37.6, *amicus* states that no counsel for a party authored any part of this brief, and no person or entity other than *amicus* and its counsel made a monetary contribution to the preparation or submission of this brief.

bers operate in every sector of the economy and transact business throughout the United States. A central function of the Chamber is to represent the interests of its members in important matters before the courts, Congress, and the Executive Branch. To that end, the Chamber has filed *amicus curiae* briefs in numerous cases that have raised issues of vital concern to the nation's business community. For example, the Chamber has previously filed briefs concerning arbitration issues before this Court in *Green Tree Financial Corp.* v. *Bazzle*, 539 U.S. 444 (2003), and *PacifiCare Systems, Inc.* v. *Book*, 538 U.S. 401 (2003).

Many of the Chamber's members, constituent organizations, and affiliates have adopted as standard features of their business contracts provisions that provide for the arbitration of disputes arising from or related to such contracts. They use arbitration because it is a fast, fair, and inexpensive method of resolving disputes with consumers and other contracting parties. Because many Chamber members may be sued in a wide range of state and federal courts, they rely on the protection afforded by the Federal Arbitration Act to ensure that their arbitration agreements are enforced consistently.

STATEMENT OF THE CASE

Respondents brought a class action lawsuit in Florida state court against Petitioner Buckeye Check Cashing, Inc., alleging that certain transactions, in which they provided Petitioner with a check to be cashed at a future date in return for an immediate cash payment, constituted usurious loans. Because the parties' contracts contained clauses agreeing to arbitrate "[a]ny claim, dispute, or controversy . . . arising from or relating to this Agreement . . . or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement" (Pet. App. 2a, 27a-28a), Petitioner moved to compel arbitration and stay the litigation. The trial court summarily denied the motion, but the intermediate appellate court reversed.

The Florida Supreme Court reversed again in a split decision, holding that because Respondents' usury claim if proven would render the entire contract—including the arbitration clause—void *ab initio* under state law, the dispute should be resolved in court. Pet. App. 7a-8a. The Florida court acknowledged that this Court held in *Prima Paint Corp.* v. *Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), that the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1 *et seq.*, requires arbitration unless a party disputes it agreed to arbitrate—even if that party claims the entire contract is unenforceable. However, the Florida court distinguished *Prima Paint* as applying only to challenges that would render a contract voidable under state law, like the fraudulent inducement claim specifically at issue in that case, and inapplicable to a claim that a contract is void *ab initio*. Pet. App. 5a-6a.

SUMMARY OF THE ARGUMENT

The Florida Supreme Court's opinion in this case illustrates a dangerous point of confusion that has developed in arbitration caselaw in the 40 years since this Court decided *Prima Paint Corp.* v. *Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967). The Court should grant certiorari to resolve the growing split between state and federal authority over the proper application of this seminal precedent.

Prima Paint held that the "plain meaning" of the Federal Arbitration Act required that courts treat the validity of an arbitration provision as a "separable" threshold issue, independent from any consideration of the validity of the parties' underlying contract. 388 U.S. at 402-404. Thus, when the *Prima Paint* plaintiffs had resisted enforcement of their arbitration agreement on the grounds that the contract as a whole had been induced by fraud, the Court found that the FAA provided jurisdiction "only [over] issues relating to the making and performance of the agreement to arbitrate." *Id.* at 404 (interpreting 9 U.S.C. § 4). Because the making of the arbitration agreement was not at issue, all other matters were to be resolved by the arbitrator. *Id.* at 403-404. This result not only complied with the plain language of the FAA,

but furthered its purposes by assuring that courts avoid unnecessary interference where parties have agreed to arbitrate their conflicts. *Id.* at 404.

The Florida Supreme Court in *Cardegna* distinguished *Prima Paint* as applying only to claims that the underlying contract is voidable under state law, but not to claims that the contract is void *ab initio*. This distinction was improper, as *Prima Paint* requires that courts limit their inquiries to "the making and performance of the agreement to arbitrate," 388 U.S. at 404, without regard to such state law distinctions.

Cardegna is merely the latest in a series of state court decisions that distinguish *Prima Paint* in this way. *See also, e.g., Alabama Catalog Sales* v. *Harris*, 794 So. 2d 312 (Ala. 2000); *Onvoy, Inc.* v. *Shal, LLC*, 669 N.W.2d 344 (Minn. 2003); *Nature's 10 Jewelers* v. *Gunderson*, 648 N.W.2d 804 (S.D. 2002). These state cases directly contradict decisions by at least five federal courts of appeals holding that allegations that a contract containing an arbitration clause is void for illegality should be subject to arbitration. *See, e.g., Bess* v. *Check Express*, 294 F.3d 1298 (11th Cir. 2002); *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Burden* v. *Check Into Cash of Ky., LLC*, 267 F.3d 483 (6th Cir. 2001); *Harter* v. *Iowa Grain Co.*, 220 F.3d 544 (7th Cir. 2000); *Lawrence* v. *Comprehensive Bus. Servs. Co.*, 833 F.2d 1159 (5th Cir. 1987); *see also Dewey* v. *Wegner*, 138 S.W.3d 591 (Tex. App. 2004).

The state cases that improperly distinguish the FAA analysis described in *Prima Paint* have serious adverse consequences for Chamber members and all other parties that rely upon agreements to arbitrate. Judicial consideration of claims that the parties' contract as a whole is void frustrates the "unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint*, 388 U.S. at 404. Furthermore, the split in authority promotes forum shopping. For example, a claim that an entire agreement (that includes an arbi-

tration provision) is void for illegality will be sent to arbitration by federal courts in the Eleventh Circuit, but remain in court in Alabama and Florida. Finally, this effort to carve out exceptions to *Prima Paint* is yet another demonstration of the enduring suspicion of arbitration that the FAA was intended to overcome.

Confusion over *Prima Paint* undermines the enforcement of arbitration provisions across the country. This Court should grant certiorari and reaffirm that the FAA requires that courts confine themselves to determining whether the making of an arbitration agreement is at issue.

REASONS FOR GRANTING THE WRIT

I. THE FLORIDA SUPREME COURT'S REFUSAL TO ENFORCE AN ARBITRATION AGREEMENT THAT WAS UNQUESTIONABLY ENTERED INTO BY THE PARTIES DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW IN A WAY THAT CONFLICTS WITH THE DECISION OF THIS COURT IN *PRIMA PAINT*.

This case involves conflicting approaches to lawsuits claiming that a contract that includes an arbitration provision is wholly invalid. Such lawsuits pose a special problem because it is uncertain where such claims should first be heard. If the contract (including the arbitration provision) is in fact unenforceable, the claim belongs in court. If the contract is valid, the claim belongs in arbitration under the terms of the parties' agreement. But a final decision as to which forum should hear the merits cannot be made until the merits have already been resolved. This conundrum requires a policy choice about which initial forum will hear such claims.

In *Cardegna*, the Florida Supreme Court resolved this dilemma by allowing litigation of plaintiffs' claims that their contract as a whole was void for illegality despite the undisputed fact that the parties had agreed to arbitrate all disputes. Pet. App. 5a-8a. That resolution conflicts with this Court's decision in *Prima Paint Corp.* v. *Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967). In *Prima Paint*, the Court determined that "Congress has provided an explicit answer" to this policy question through the Federal

Arbitration Act, which requires that the court order arbitration as soon as it is satisfied that "'the making of *the agreement for arbitration* or the failure to comply (with the arbitration agreement) is not in issue.'" 388 U.S. at 403 (quoting 9 U.S.C. § 4) (alteration in original, emphasis added).

Thus, in passing on an application for a stay pending arbitration under section 3 of the FAA, *Prima Paint* held that courts "may consider only issues relating to the making and performance of the agreement to arbitrate." *Id.* at 404. For example, a court could resolve claims of "fraud in the inducement of the arbitration clause itself . . . [b]ut the statutory language does not permit . . . consider[ation] [of] claims of fraud in the inducement of the contract generally." *Id.* at 403-404. In *Prima Paint*, the absence of claims directed to the making of the arbitration provision itself meant that the contract dispute should be arbitrated. *Id.* This result was supported not only by "the plain meaning of the statute, but also the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Id.* at 404.[2]

In the instant case, there was no dispute below that the parties had made a written agreement, and that it contained a broad arbitration provision. Pet. App. 2a. The borrowers only contended that the underlying contract was void as a matter of Florida policy or law. *Id.* Thus, under *Prima Paint*, once the courts had established that "'the making *of the agreement for arbitration* . . . is not in issue,'" 388 U.S. at

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[2] Justice Black argued in dissent that the majority's decision improperly exalted arbitration provisions by enforcing them while the enforceability of the remainder of the contract remains at issue. *See* 388 U.S. at 423 (Black, J. dissenting) (stating that the FAA was only intended to place arbitration agreements "'upon the same footing as other contracts'" (citation omitted)). However, the alternative approach taken by the *Cardegna* court—judicial consideration of general contract claims before any arbitration is ordered—would render arbitration agreements nugatory by resolving in court disputes that may well be subject to a valid arbitration agreement.

403 (quoting 9 U.S.C. § 4) (emphasis added), the arbitration provision was enforceable as a matter of federal substantive law, and the merits of the case (that is, a decision about the validity of the entire contract) should have been directed to arbitration instead of decided by the court.

Nevertheless, the Florida Supreme Court explained that "the rationale of *Prima Paint* should not be extended to the facts of this case," because "if the underlying contract is held entirely void as a matter of [state] law, all of its provisions, including the arbitration clause, would be nullified as well." Pet. App. 5a-6a. The court's conclusion that the risk of such nullification was grounds for not enforcing the parties' arbitration provision was based on state law: "Florida public policy and contract law prohibit breathing life in to a potentially illegal contract by enforcing the included arbitration clause of the void contract . . . there are no severable, or salvageable, parts of a contract found illegal and void under Florida law." *Id.* at 7a-8a. In short, the *Cardegna* court found that Florida law forbade the application of *Prima Paint.*

This approach conflicts with *Prima Paint* and ignores the pre-emptive effect of the FAA. The clearest proof of the conflict is that the Florida court's decision essentially adopts the logic of the *dissent* in *Prima Paint.* Justice Black had argued, in his dissenting opinion, that fraudulent inducement challenges to a contract as a whole should be decided by courts because "[i]f the contract was procured by fraud, then, unless the defrauded party elects to affirm it, there is absolutely no contract, nothing to be arbitrated." 388 U.S. at 412 (Black, J., dissenting). In *Cardegna,* the argument is the same, except that it is now applied to state law claims that the contract is unenforceable for illegality rather than for fraudulent inducement. This invocation of "Florida public policy and contract law" (Pet. App. 7a), to forbid arbitration of certain types of contract challenges not only contradicts *Prima Paint,* but is pre-empted by the Federal Arbitration Act. *See, e.g., Doctor's Assocs., Inc.* v. *Casarotto,* 517 U.S. 681, 683 (1996); *Mastrobuono* v. *Shearson Lehman Hutton,*

Inc., 514 U.S. 52, 57-58 (1995); *Southland Corp.* v. *Keating*, 465 U.S. 1, 12-15 (1984).

Cardegna justified this result by relying on previous state and federal cases that have distinguished *Prima Paint* as applying only to challenges that would render a contract voidable under state law, but not to challenges that would render a contract void *ab initio*. Pet. App. 6a-7a.[3] As is described in detail *infra*, this distinction is a source of considerable conflict and confusion in both state and federal appellate courts. However, it is not a distinction that matters in the context of *Prima Paint*.

Prima Paint explains that the FAA requires as a matter of substantive federal law that courts focus solely on "issues relating to the making and performance of the agreement to arbitrate," and refer remaining disputes to arbitration if the arbitration agreement itself is not at issue. 388 U.S. at 404. This reading of the FAA does not turn on whether the state law involved would make the contract void or merely voidable.[4] Indeed, *Prima Paint* specifically

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[3] A "voidable contract" is generally defined as "[a] contract that can be affirmed or rejected at the option of one of the parties; a contract that is void as to the wrongdoer but not void as to the party wronged, unless that party elects to treat it as void." *Black's Law Dictionary* 350 (8th ed. 2004). A "void contract," in contrast, is generally defined as "[a] contract that is of no legal effect, so that there is really no contract in existence at all." *Id.* Void contracts generally fall into two categories, one involving contracts in which one of the normal requirements for the creation of a contract (such as assent) is absent, and the other in which the normal requirements are satisfied but the agreement is deemed unenforceable because the law disapproves of its purpose or the terms by which it seeks to achieve such purpose. *Id.* (quoting P.S. Atiya, *An Introduction to the Law of Contract* 36-37 (3d ed. 1981)). *See generally Restatement (Second) of Contracts*, § 7 & cmt. a (1981); 1 *Corbin on Contracts* §§ 1.6, 1.7 (Joseph M. Perillo ed., 1993); Joseph M. Perillo, *Calamari & Perillo on Contracts* § 1.8 (5th ed. 2003).

[4] Nothing in the majority opinion or the dissent accords any particular significance to the fact that it was technically possible for the plaintiffs to ratify their contract under state law. The majority opinion does not focus at all on the specific nature of the challenge to enforceability under state law. *See id.* at 402-404. And the dissent criticizes the majority opin-

rejected a decision by the Court of Appeals for the First Circuit that had suggested that the issue whether an arbitration clause is separable from the underlying contract should be determined by state law. *Id.* at 402-403 (discussing *Lummus Co.* v. *Commonwealth Oil Ref. Co.*, 280 F.2d 915 (1st Cir. 1960)); *see also id.* at 404-406 (holding that the FAA is an exercise of Congress's Commerce Clause powers and must be applied by federal courts even in diversity jurisdiction cases).

Thus, certiorari is warranted because *Cardegna* "decided an important federal question in a way that conflicts with relevant decisions of this Court." Sup. Ct. R. 10(c). Although this Court has not had occasion to revisit the specific issues presented by *Prima Paint* in nearly 40 years, it has reaffirmed generally in subsequent decisions that because "the policy of the Arbitration Act requires a liberal reading of arbitration agreements ... some issues that might be thought relevant to arbitrability are themselves arbitrable." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 22 n.27 (1983) (discussing *Prima Paint*). Indeed, *Prima Paint*'s separability rule is simply a specific application of the general principle that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Id.* at 24-25; *see also, e.g.*, *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 & n.8 (1995); *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985).

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ion in a manner that obliterates any distinction between void and voidable contracts: Justice Black's concern was that "a court might, after a fair trial, hold the entire contract—including the arbitration agreement—*void* because of fraud in the inducement." *Id.* at 407 (Black, J., dissenting) (emphasis added).

II. THE FLORIDA SUPREME COURT'S REFUSAL TO ENFORCE AN ARBITRATION AGREEMENT IN A CONTRACT ALLEGED TO BE VOID DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW IN A WAY THAT DIRECTLY CONFLICTS WITH THE DECISIONS OF AT LEAST FIVE FEDERAL COURTS OF APPEALS

Even if it could legitimately be determined that there were no direct conflict between the decision below and *Prima Paint* itself, certiorari is warranted because there is a unambiguous split in authority between at least four state supreme courts, on the one hand, and at least five federal courts of appeals, on the other, regarding the arbitrability of allegations that a contract is void for illegality. *See* Sup. Ct. R. 10(b).

The Florida Supreme Court is one of many state appellate courts that have held that claims that a contract is illegal and so void should be withheld from arbitration. *See Alabama Catalog Sales* v. *Harris*, 794 So. 2d 312 (Ala. 2000) (alleged violation of usury law); *R.P.T. of Aspen, Inc.* v. *Innovative Communications, Inc.*, 917 P.2d 340 (Colo. Ct. App. 1996) (state antitrust law); Pet. App. 6a-7a (usury law); *Onvoy, Inc.* v. *Shal, LLC*, 669 N.W.2d 344 (Minn. 2003) (corporate statute concerning transactions approved by interested directors); *Nature's 10 Jewelers* v. *Gunderson*, 648 N.W.2d 804 (S.D. 2002) (franchise registration statute).

Many of these state court decisions rely upon a set of opinions by federal courts of appeal that have mistakenly suggested that state law distinctions between void and voidable contracts are relevant to the application of *Prima Paint*. This error is largely traceable to *Three Valleys Municipal Water District* v. *E.F. Hutton & Co.*, 925 F.2d 1136 (9th Cir. 1991), which held that a court should hear a dispute over whether a particular signatory had authority to bind a particular party to a contract that included an arbitration provision. That holding was consistent with *Prima Paint*, as a party who asserts that it never assented to *any* part of a contract has raised an "issue[] relating to the making and performance of the agreement to arbitrate." 388 U.S. at 404. However, the Ninth Circuit supported its holding by assert-

ing that *Prima Paint* was "limited to challenges seeking to *avoid* or *rescind* a contract—not to challenges going to the very existence of a contract that a party claims never to have agreed to," and that "*Prima Paint* applies [only] to 'voidable' contracts." 925 F.2d at 1140. Several federal courts of appeals have followed *Three Valleys*' void/voidable distinction when deciding the arbitrability of claims that a party did not assent to a contract. *See, e.g., Sphere Drake Ins.* v. *Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 31 (2d Cir. 2001); *Sandvik AB* v. *Advent Int'l Corp.*, 220 F.3d 99, 106-107 (3d Cir. 2000); *Chastain* v. *Robinson Humphrey Co.*, 957 F. 2d 851, 855 (11th Cir. 1992).

Cardegna and several other state decisions have extended the void/voidable distinction beyond cases in which assent was allegedly lacking, to encompass claims that the contract was illegal under state law. That application creates a direct conflict with a group of federal courts of appeals that have held that such illegality challenges are subject to arbitration under *Prima Paint*. *See, e.g., Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 880-882 (11th Cir. 2005); *Bess* v. *Check Express*, 294 F.3d 1298, 1304-1306 (11th Cir. 2002); *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631, 636-638 (4th Cir. 2002); *Burden* v. *Check Into Cash of Ky., LLC*, 267 F.3d 483, 488-492 (6th Cir. 2001); *Harter* v. *Iowa Grain Co.*, 220 F.3d 544, 550-551 (7th Cir. 2000); *Lawrence* v. *Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1161-1162 (5th Cir. 1987); *see also Dewey* v. *Wegner*, 138 S.W.3d 591, 597-602 (Tex. App. 2004).

The analytical problem that underlies this conflict is that the state law concepts underlying "void contracts" and "voidable contracts" do not align with *Prima Paint*'s analysis of whether a particular dispute raises an issue directly "relating to the making and performance of the agreement to arbitrate." 388 U.S. at 404. In particular, the term "void contract" may be used to refer *either* to situations in which no contract was ever formed (*e.g.*, because one party never assented) *or* to situations in which the parties' contract is merely unenforceable for policy reasons (*e.g.*, because one of

the parties lacked a license to conduct a certain activity, or because the substantive terms of the contract violated a state statute). *See supra* n.3. The first scenario, which was at issue in *Three Valleys* and the federal cases following it, raises an issue that relates to the making of the parties' arbitration agreement, since it challenges whether *any* agreement was reached. In contrast, the second scenario, which was at issue in *Cardegna* and similar state court cases, challenges only the substantive terms of the underlying contract. This latter type of challenge does not relate to the making of the arbitration agreement, and so is subject to arbitration under *Prima Paint.*

At least five federal courts of appeals have recognized that not all claims that a contract is void are grounds for allowing a party to evade arbitration. *See Bess*, 294 F.3d at 1305; *Snowden*, 290 F.3d at 637; *Burden*, 267 F.3d at 490; *Harter*, 220 F.3d at 550-551; *Lawrence*, 833 F.2d at 1161-1162. In contrast, *Cardegna* and other state appellate cases have treated all claims that a contract is void as subject to adjudication, notwithstanding *Prima Paint. See Alabama Catalog Sales*, 794 So. 2d at 314-317; *R.P.T. of Aspen*, 917 P.2d at 342; Pet. App. 6a-8a; *Onvoy*, 669 N.W.2d at 352-356; *Nature's 10 Jewelers*, 648 N.W.2d at 807. As noted by Justice Bell in his special concurrence in *Cardegna*, a grant of certiorari is the only way to resolve the growing conflict over this issue, since state courts are not bound by the decisions of federal courts of appeal. Pet. App. 9a (Bell, J., specially concurring).

III. THERE IS A COMPELLING NEED FOR CERTIORARI TO PREVENT *CARDEGNA* AND SIMILAR DECISIONS FROM UNDERMINING THE GOALS AND CONSISTENT APPLICATION OF THE FAA

The state court decisions that improperly distinguish *Prima Paint* undermine the core goals of the FAA. Absent a ruling reaffirming the breadth of *Prima Paint*'s holding and the supremacy of federal law on this issue, courts will face increasing numbers of claims that contracts are void, as parties invoke and attempt to expand contract doctrines that

allow them—in some state courts—to evade their obligation to arbitrate.

Decisions such as *Cardegna* have direct negative impacts on the use of arbitration clauses across the country. First, they prolong litigation and thus increase "the very kind of costs and delay . . . that Congress wrote the [Federal Arbitration] Act to help the parties avoid." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 278 (1995). This issue is a concern not only for the party actually forced to litigate a matter that properly belongs in arbitration, but for the wide range of other businesses and organizations, including Chamber members, who face increased uncertainty regarding the enforceability of arbitration agreements incorporated into their contracts.

Second, decisions misinterpreting *Prima Paint* undermine the uniformity of the FAA and provide a significant incentive to forum-shop. In the Eleventh Circuit, for example, a challenge to the parties' contract as void for illegality will be referred to arbitrators if heard in federal court, but will be decided by state judges in Alabama and Florida. *Compare Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 880-882 (11th Cir. 2005), *and Bess* v. *Check Express*, 294 F.3d 1298, 1304-1306 (11th Cir. 2002), *with Alabama Catalog Sales* v. *Harris*, 794 So. 2d 312, 314-317 (Ala. 2000), *and* Pet. App. 7a-8a. That risk of inconsistent results is antithetical to the FAA and creates significant tension with this Court's decisions on the pre-emptive force of the FAA. *See, e.g., Southland Corp.* v. *Keating*, 465 U.S. 1, 15 (1984) ("We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted."). This issue is of vital importance to many of the businesses represented by the Chamber, which rely on the FAA to ensure that their arbitration agreements are enforced consistently across the many jurisdictions in which they do business.

Third, the evasion of the rule in *Prima Paint* is simply the latest manifestation of the persistence of judicial suspicion toward arbitration. At bottom, the courts that fail to order arbitration of certain contract claims have decided that it is better to litigate issues that might be subject to arbitration than to arbitrate issues that might belong in court. That choice is not only at odds with the FAA and *Prima Paint*, *see supra* pp. 5-9, but the long line of Supreme Court cases rejecting generalized attacks based on "'suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants,'" *Green Tree Fin. Corp.-Ala.* v. *Randolph*, 531 U.S. 79, 89-90 (2000) (citation omitted), and "the presumption that the parties and arbitral body conducting a proceeding will be unable or unwilling to retain competent, conscientious, and impartial arbitrators," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 634 (1985). *See also Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (cataloguing previous cases "recogniz[ing] that '[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum'" (citation omitted)). Here, as in *Randolph*, *Mitsubishi Motors*, *Gilmer* and a host of other cases, certiorari is necessary to reinforce the strong federal policy in favor of arbitration.

Indeed, if the Court does not resolve the split in authority and reaffirm its holding in *Prima Paint*, courts are likely to see a rise in voidness challenges, as parties attempt to find reasons to claim that a contract is void rather than voidable to evade arbitration.[5] Depending on the particular

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[5] The persistence of attacks on arbitration strongly suggests that any claim that allows litigation rather than arbitration will become common. For example, the FAA allows unconscionability challenges to arbitration agreements because such challenges are generally applicable to any contract. 9 U.S.C. § 2. However, now *most* unconscionability cases involve arbitration agreements. *See* Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 194-196 (2004) (finding that the total number of unconscionabil-

state's case law, a contract may be void not only if it involves the commission of a crime or tort or involves the violation of a state statute that specifically provides that contravening contracts are void, but also if it conflicts with general regulatory or administrative statutes, *see, e.g.*, *Calamari & Perillo on Contracts* § 22.1, or is otherwise contrary to public policy under various balancing tests, *see Restatement (Second) of Contracts* § 194. There is substantial uncertainty and complexity to such claims. *See generally* 15 *Corbin on Contracts* §§ 79.1-79.5 (Joseph M. Perillo ed., 2003); 5 *Williston on Contracts* §§ 12.1-12.3 (Richard A. Lord ed., 4th ed. 1993); 6 *Williston on Contracts* § 12.4 (Richard A. Lord ed., 4th ed. 1995). Under the rule in *Cardegna*, cases involving such allegations promise prolonged litigation before a court can determine whether litigation—rather than arbitration—is appropriate. Such prolonged litigation entails significant time and expense to businesses that, under *Prima Paint*, should not be in court at all.

This Court has repeatedly rejected past attempts to impede the functioning of the FAA and of parties' arbitration agreements by imposing procedural or substantive burdens that would increase pre-arbitration litigation and undermine "Congress's clear intent, in the Arbitration Act, to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible," *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983). *See, e.g.*, *Randolph*, 531 U.S. at 90-91 (refusing to hold arbitration agreements invalid based on vague allegations that the costs of arbitration might prevent parties from vindicating their federal statutory rights); *Allied-Bruce Terminix*, 513 U.S. at 275 (rejecting an assertion that parties must demonstrate that they intended their contract to involve interstate commerce to come within the scope of the FAA because such a result would "risk[] the very kind of costs and delay through

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ity cases available through computerized searches jumped from 54 in 1982-1983 to 235 in 2002-2003 and that nearly 70% of the recent cases involved claims that arbitration agreements were unconscionable).

litigation (about the circumstances of contract formation) that Congress wrote the Act to help the parties avoid"); *Southland*, 465 U.S. at 7 (refusing to delay Supreme Court review of a state judicial decision denying enforcement of an arbitration provision because prolonged litigation is "one of the very risks the parties, by contracting for arbitration, sought to eliminate"); *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967) (recognizing the separability doctrine as furthering the "unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts"). Certiorari in this case would once again help protect the FAA from being undermined by state law doctrines that prevent the enforcement of arbitration agreements.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted.

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MAY 2005

(10)

Supreme Court, U.S.
FILED
MAY 23 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE
Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Florida

BRIEF OF *AMICUS CURIAE* COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*

Amicus curiae Community Financial Services Association of America ("CFSA") is the national trade association for the payday advance industry, representing the owners of more than one-half of the estimated 22,000 payday advance retail outlets in the United States. *Amicus curiae* has authored this brief in whole, and has no stake in any of the parties to this litigation.[1] *Amicus curiae* has no interest in the outcome of this case, other than in seeking, on behalf of its members, the correct and consistent application of federal law to claims such as those asserted in this action.

Amicus curiae has established - and enforces among its members - responsible industry practices and appropriate consumer rights and protections ("Best Practices"). The Best Practices of *amicus curiae* (attached as Exhibit A) require its members to comply with all applicable laws and regulations; to disclose fully the terms and cost of each transaction; to limit renewals of payday advances; to encourage consumers to use this service responsibly by informing consumers of the intended use of the product and by notifying them of credit counseling alternatives; to provide consumers with a next-day right of rescission; and to refrain from the threat or pursuit of criminal action for collection purposes.

Many payday advance providers, including Petitioner Buckeye Check Cashing, Inc. and other *amicus curiae* members, include arbitration clauses in their transaction agreements. Throughout the payday advance industry, arbitration clauses are important provisions to help speedily

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[1] Petitioner, Buckeye Check Cashing, Inc., is a member of *amicus curiae*. This brief represents the perspective of *amicus curiae* and not of any party. Petitioner has not borne any portion of the cost of preparation of this brief, other than through its payments of ordinary membership dues to *amicus curiae*. The parties have consented to the filing of this brief, and letters evidencing such consent have been filed with the Clerk of this Court, pursuant to S. Ct. R. 37.2.

resolve disputes in an inexpensive way. *Amicus curiae* believes that the interests of the payday advance industry and of the consuming public are best protected by the holdings of six federal courts of appeals, which have stated that the Federal Arbitration Act does not allow a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality. The holdings of two state supreme courts are to the contrary, so it is in the interest of *amicus curiae* for the Court to resolve the conflict between the federal courts and the state courts. Not only will the outcome of this matter have a long-lasting and economically powerful impact on members of *amicus curiae*, it also will have far-reaching implications for financial institutions, which consistently use arbitration provisions in their credit-related agreements, as well as for consumers.

Accordingly, *amicus curiae* strongly supports Petitioner in this petition for writ of certiorari.

SUMMARY OF THE ARGUMENT

During the past several years, the payday advance industry has become a major financial resource for millions of consumers. It is estimated that there are over 22,000 individual payday advance outlets in the United States, and that the industry provided over $40 billion in payday advances in 2003. The growth of this industry is a direct result of consumer demand. Payday advances are popular with consumers because they compare favorably with, and are often less expensive than, other alternatives.[2] The payday advance industry is heavily regulated. Payday advance providers are subject to state loan and/or check cashing laws, the disclosures mandated by the federal Truth-in-Lending Act, and the prohibitions on unfair and deceptive trade

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[2] For example, overdraft protection products and late fees.

practices contained in the Federal Trade Commission Act. Arbitration clauses have long been features of payday advance agreements. They allow payday advance customers and payday advance firms to resolve disputes in a low cost, speedy and efficient manner. Payday advance customers and payday advance firms would be denied these benefits if providers are unable to rely upon arbitration clauses included in payday advance agreements.

ARGUMENT

I. PAYDAY ADVANCES SATISFY A CONSUMER NEED AND ARE HEAVILY REGULATED

The typical payday advance involves a small, unsecured, short-term cash advance until the next payday for an employed worker who maintains a checking account. It is a very simple transaction with the finance charge expressed clearly as both a dollar amount and as an annual percentage rate ("APR"). To obtain such an advance, the consumer applies with very basic credit information and enters into an agreement that fully complies with applicable federal and state disclosure requirements, including disclosure of the APR. The consumer writes a personal check for the advance amount plus a finance charge and immediately receives the transaction proceeds by cash, electronic funds transfer or check. The lender holds the check until the borrower's payday, usually in about two weeks. Payday advances are short-term transactions and most generally are used to navigate unanticipated cash-flow problems, such as repair of an automobile needed to get to and from work; medical expenses; or an unexpected home-repair bill.

Most consumers use the product responsibly, and generally for the purpose intended, namely, to solve temporary cash-flow problems by bridging the gap between paydays. The payday advance industry serves a credit void. Traditional lenders have elected during the past decade to

abandon the small, short-term loan market. Most commercial banks generally do not make unsecured loans for less than $5,000 - and then only to high credit-quality consumers. This decision reflects the larger trend among depository institutions of under serving particular market segments perceived as unprofitable for them.

The consolidation of the banking industry has further deprived consumers of access to traditional sources of small loans. The closing of redundant bank branches has resulted in the absence of brick-and-mortar financial services storefronts in many areas of the country. Because payday advance borrowers generally have limited small-denomination sources of credit available to them, a payday advance satisfies their credit needs. Testimony of the National Taxpayers Union supports this conclusion:

> There is overwhelming evidence that payday advance loans provide a valuable service, filling a critical financial need for millions of Americans in states across the country. In one of those states, North Carolina, a recent report by the State Commissioner of Banks revealed just how well-received by consumers the payday loan option has been there. The report cited 2.9 million North Carolina transactions in 1999, with the Commissioner of Banks receiving only 12 complaints.

Testimony of Al Cors, Jr., Vice President, Government Affairs, National Taxpayers Union, before the California Assembly Committee on Business and Professions (Nov. 14, 2001).[3]

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[3] http://www.ntu.org/features/ntu_on_capitolhill/T011CorsPayDayLoan.php3.

A study that analyzes consumer satisfaction with payday advances, conducted by the Cypress Research Group in 2004, reinforces this point.[4] In the survey, 2000 payday advance customers who had obtained a payday advance within the past three months were asked about several aspects of their satisfaction with their recent payday advance. Those customers surveyed indicated the following:

- In comparison to other financial products with which they had recent experiences, the payday advance was among the most highly rated (75% satisfied), second only to check overdraft protection.
- Customers surveyed were highly satisfied with general aspects of the payday advance experience, such as the level of service during the application process (88% satisfied), the level of service while the payday advance was outstanding (85%), and the payday advance itself (82%).
- Regarding other aspects of the payday advance, 85% were satisfied with the ability to renew the payday advance, 82% were satisfied with the maximum payday advance amount allowed, and 77% were satisfied with the payday advance repayment schedule.

The results of this survey indicate strong consumer satisfaction with the payday advance industry.[5]

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[4] Cypress Research Group on behalf of CFSA, "Payday Advance Customer Satisfaction Survey," May 2004.

[5] *See id.* pp. 4-5.

In addition, with respect to pricing of the product, a recently released study by the Federal Deposit Insurance Corporation's Center for Financial Research[6] suggests that payday advances are not excessively priced when all of the costs associated with making the advance are considered. The authors concluded that, "[t]o a great extent, the 'high' APRs implied by payday loan fees can be justified by the fixed costs of keeping stores open and the relatively high default losses suffered on these loans."[7] The study found that the structure of the payday advance product makes it costly to provide such short-term advances, and that the product's default rates substantially exceed the usual credit losses at financial institutions.[8]

Payday advance firms are subject to state and federal regulation. As a general rule, they may operate only in those states in which they may be licensed. Currently, 37 states and the District of Columbia have adopted such licensing statutes. The only exception to this general rule is that some payday advance firms act as agents for commercial banks in a few states that do not otherwise license payday advance providers. In those instances, however, the payday advance firm only provides marketing and administrative services to the commercial bank, which enters into the loan agreement with the borrower and funds the loan.

State licensing statutes typically impose a number of conditions on payday advance firms. These include limits on the overall advance amount, the term of the advance,

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[6] Flannery and Samolyk, "Payday Lending: Do the Costs Justify the Price?," Federal Deposit Insurance Corporation Division of Insurance and Research, April 2005.

[7] *Id.* at 21.

[8] *See id.* p. 2.

maximum fees that can be charged and the number of renewals. Some states also mandate 'cooling off' periods between transactions, and others prohibit payday advance providers from conducting a transaction with a customer who has an outstanding payday advance from another firm.

The principal federal laws relevant to payday advances are the Truth-in-Lending Act, 15 U.S.C. §§ 1601 *et seq.*, and the Federal Trade Commission Act, 15 U.S.C. §§ 41 *et seq.* The Truth-in-Lending Act requires that payday advance firms disclose the cost of a payday advance in dollar amount and annual percentage terms. When the Federal Reserve Board, which implements the Truth-in-Lending Act, proposed a regulation subjecting payday advances to this disclosure requirement, CFSA filed a comment in support of the regulation.

Section 5 of the Federal Trade Commission Act prohibits companies such as payday advance firms from engaging in unfair and deceptive marketing practices, and empowers the Federal Trade Commission to take civil actions against any company that engages in such practices.[9]

II. ARBITRATION CLAUSES IN THE PAYDAY ADVANCE INDUSTRY ARE IMPORTANT AND USEFUL TO CONSUMERS

Since the mid-1990s, the trend toward including arbitration clauses in consumer agreements has accelerated dramatically. Congress, via the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.*, and many states, through adoption of the Uniform Arbitration Act, have recognized the importance of arbitration in contract disputes. In the payday advance industry, arbitration clauses in consumer agreements have become standard. Given the small amount of a payday

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[9] 15 U.S.C. § 45.

advance, arbitration is particularly well-suited to resolve disputes.

Arbitration provides many important advantages for both businesses and consumers in resolving disputes: it provides efficient resolution and fair access to justice; it is usually less expensive and faster than litigation; it is often less disruptive and hostile as uncertainties regarding the dispute resolution process are avoided; and arbitrators can be chosen for their expertise in the subject matter in dispute. Other advantages include simpler procedural and evidentiary rules and flexibility with respect to scheduling hearings.

The case for arbitration has been set forth by Congress a number of times over the years. In recommending passage of the Federal Arbitration Act in 1924, the Senate Judiciary Committee determined that arbitration allows parties to "avoid the delay and expense of litigation," and so appealed to "business . . . as well as to individuals."[10] Years later, in 1982, a House Committee found that "[t]he advantages of arbitration are many; it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive . . . [and] it is often more flexible in regard to scheduling of times and places of hearings."[11] More recently, Congress stated in the Y2K Act that arbitration is useful because "individuals already find [the legal] system inaccessible because of its complexity and expense."[12]

In February 2005, the National Arbitration Forum, one of the country's three leading alternative dispute resolution

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[10] S. Rep. No. 68-536, at 3 (1924).

[11] H.R. Rep. No 97-542 (1982).

[12] 15 U.S.C. §§ 6601 *et seq.*.

organizations, announced that a study conducted by Ernst & Young, entitled *Outcomes of Arbitration: An Empirical Study of Consumer Lending*,[13] confirmed that consumers find the arbitration process to be advantageous and beneficial in resolving disputes. Results of the study revealed that consumers prevail in arbitrations conducted by the National Arbitration Forum at the same rate they prevail in state court - 55%. A survey taken as part of the study of a small random sample of claimants in consumer arbitration reinforced consumer satisfaction with respect to resolution, process, cost, and timeliness of arbitration. Consequently, it is in the interest of both lenders and consumers to resolve disputes in arbitration rather than in traditional lawsuits.

CONCLUSION

For the reasons set forth above, *amicus curiae* strongly supports Petitioner and urges the Court to resolve the conflict among certain state supreme courts and federal circuit courts of appeal on the issue of whether the Federal Arbitration Act allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality.

Respectfully submitted,

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[13] http://www.arb-forum.com/EY_2005.pdf.

APPENDIX

EXHIBIT A

Best Practices for the Industry

To be a member in good standing of CFSA, a payday advance provider must abide by the following best practices:

1. **Full disclosure.** A member will comply with the disclosure requirements of the State in which the payday advance office is located and with Federal disclosure requirements including the Federal Truth in Lending Act. A contract between a member and the customer must fully outline the terms of the payday advance transaction. Members agree to disclose the cost of the service fee both as a dollar amount and as an annual percentage rate ("APR").

2. **Compliance.** A member will comply with all applicable laws. A member will not charge a fee or rate for a payday advance that is not authorized by State or Federal law.

3. **Truthful advertising.** A member will not advertise the payday advance service in any false, misleading, or deceptive manner.

4. **Encourage consumer responsibility.** A member will implement procedures to inform consumers of the intended use of the payday advance service. These procedures will include notifying consumers that a payday advance is a short-term cash flow tool not designed as a solution for longer term financial problems and informing customers of the availability of credit counseling services.

5. **Rollovers.** A member will comply with State laws on rollovers (the extension of an outstanding advance by payment of only a fee). In States where rollovers are

not specifically allowed a member will not under any circumstances allow a customer to do a rollover. In the few States where rollovers are permitted, a member will limit rollovers to four (4) or the State limit, whichever is less.

6. **Right to rescind.** A member will give its customers the right to rescind, at no cost, a payday advance transaction on or before the close of the following business day.

7. **Appropriate collection practices.** A member must collect past due accounts in a professional, fair and lawful manner. A member will not use unlawful threats, intimidation, or harassment to collect accounts. CFSA believes that the collection limitations contained in the Fair Debt Collection Practices Act (FDCPA) should guide a member's practice in this area.

8. **No criminal action.** A member will not threaten or pursue criminal action against a customer as a result of the customer's check being returned unpaid or the customer's account not being paid.

9. **Enforcement.** A member will participate in selfpolicing of the industry. A member will be expected to report violations of these Best Practices to CFSA, which will investigate the matter and take appropriate action. Each member company agrees to maintain and post its own toll-free consumer hotline number in each of its outlets.

10. **Support balanced legislation.** A member will work with State legislators and regulators to support responsible legislation of the payday advance industry that incorporates these Best Practices.

11. **Relationships with financial institutions.** A member may market and service payday advances made by a federally insured financial institution, provided the financial institution does the following: (1) sets its own credit criteria; (2) approves and funds each advance; (3) complies with applicable State disclosure requirements, where not inconsistent with Federal law; (4) complies with applicable State law as to the number of rollovers; (5) permits the member to purchase no more than a de minimis amount of the advances, or any such other amount which may be consistent with safety and soundness determinations by Federal or State banking regulators; (6) complies with the guidelines and regulations on payday lending issued by the financial institution's Federal or State regulator; and (7) complies with these Best Practices unless the Best Practices conflict with this Paragraph, in which case the terms of this Paragraph shall apply.

12. **Military.** A member will comply with a separate code of Military Best Practices that addresses the unique circumstances of active duty military customers. These special consumer protections include, among others: a prohibition on the garnishment of military wages or salaries and on contacting the military chain of command to collect payment; and the establishment of financial literacy initiatives that will benefit service men and women.

2005

Supreme Court, U.S.
FILED
MAY 23 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

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Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Florida

BRIEF OF *AMICI CURIAE* FLORIDA BANKERS ASSOCIATION AND AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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On Petition for Writ of Certiorari to the Supreme Court of Florida

INTEREST OF *AMICI CURIAE*[1]

Amicus curiae Florida Bankers Association ("FBA") is a voluntary organization of financial institutions doing business in the State of Florida. FBA regularly represents the interests of its members before all branches of government and frequently appears as an *amicus curiae* in the state and federal courts, including, on several occasions, before this Court. The issue in this case is of particular importance to FBA and

[1] This brief is filed with the written consent of all parties. No counsel for a party authored this brief in whole or in part, nor did any person or entity, other than *amici* or their counsel, make a monetary contribution to the preparation or submission of this brief.

its members because arbitration agreements are a significant way in which FBA members attempt to promote the efficient and inexpensive resolution of disputes. By undermining the application and enforceability of arbitration clauses, the decision below, if allowed to stand, will impose greater costs and greater uncertainty upon FBA's members.

Amicus curiae American Bankers Association ("ABA") is the principal national trade association of the banking industry in the United States. ABA has members in each of the fifty states and the District of Columbia. ABA member banks hold approximately 90% of the domestic assets of the banking industry in the United States. ABA frequently appears in litigation as a party or *amicus* where issues raised in a case are of widespread importance and concern to the industry. The issue in this case is of precisely such importance and concern to the banking industry because the decision below and others like it threaten to undermine the tremendous benefits of arbitration agreements used in the banking industry and to divert numerous disputes into the more expensive and less efficient state-court system.

SUMMARY OF ARGUMENT

1. Arbitration agreements occur in numerous and diverse contracts across all aspects of the United States economy. Their consistent and certain enforceability is thus of great national importance and has the potential to affect a tremendous amount of economic activity. The particular issue in this case – whether claims of contract invalidity not specifically related to the arbitration agreement are to be decided by the court or the arbitrator – likewise arises in connection with numerous contracts, based on many different claims of illegality, and across multiple and varied industries. This case thus has far broader significance than just to the parties themselves; it affects the banking industry and other industries throughout the country. The petition thus presents an issue of national importance warranting this Court's attention.

2. In order to give proper effect to federal law protecting arbitration agreements, such agreements must be treated as severable from the agreements to which they relate and their validity must be analyzed independently from the validity of such underlying contracts. The decision below instead conflated the issue of underlying contractual validity and arbitration-agreement validity thus nullifying arbitration agreements in many contexts. And it did so out of a seeming hostility to arbitration that is diametrically contrary to federal policy.

ARGUMENT

Amici agree with petitioner that the decision below is part of a clear and irreconcilable split between state supreme courts and federal circuit courts, that it creates an intolerable inconsistency within Florida itself given its divergence from Eleventh Circuit case law, and that it applies a fundamentally incorrect legal rule that conflicts with both the letter and the purposes of the Federal Arbitration Act ("FAA").

Rather than belabor matters already well-articulated by petitioner, *amici* will focus on why this case is important and deserving of this Court's limited time and attention, and will briefly expand upon the important principle of severability of arbitration clauses and how state-court disregard for that principle manifests an impermissible hostility toward arbitration.

I. THE PETITION RAISES AN IMPORTANT AND RECURRING ISSUE AFFECTING NUMEROUS TRANSACTIONS IN A BROAD ARRAY OF INDUSTRIES.

Arbitration agreements appear in a wide variety of contracts in the banking and other industries. Those underlying contracts are often the target of claims of illegality having nothing to do with the arbitration clauses themselves but that, under the decision below, would effectively nullify the agreement to arbitrate. While the petition highlights the existing split with cases primarily involving so-called pay-day

lending agreements, the importance of the issue presented goes far beyond that particular business area and covers a tremendous range of banking and other activities.

A. The Arbitrability of Claims of Contract Illegality Affects a Broad Range of Transactions Across Multiple Industries.

As this Court is certainly well aware, arbitration clauses appear in an extensive array of contracts involving a myriad of goods and services. *See, e.g.*, *Green Tree Financial Corp.* v. *Bazzle*, 539 U.S. 444, 447 (2003) (home improvement loan agreement); *Citizens Bank* v. *Alafabco, Inc.*, 539 U.S. 52, 53 (2003) (commercial construction debt restructuring agreement); *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 109 (2001) (employment agreement); *Green Tree Financial Corp.-Alabama* v. *Randolph*, 531 U.S. 79, 82 (2000) (mobile home financing and insurance agreement); *Wright* v. *Universal Maritime Service Corp.*, 525 U.S. 70, 72 (1998) (longshoremen's collective bargaining agreement); *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 54 (1995) (securities brokerage account agreement); *Allied-Bruce Terminix Companies, Inc.* v. *Dobson*, 513 U.S. 265, 268 (1995) (termite control contract); *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (registered securities representative registration/employment agreement); *Volt Information Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 470 (1989) (construction contract); *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 616-17 (1985) (automobile manufacturer distribution and sales agreement); *General Atomic Co.* v. *Felter*, 436 U.S. 493, 494 (1978) (uranium supply agreement); *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (paint manufacturing and sales consulting agreement). It is the widespread use of arbitration agreements, and the strong federal policy favoring such agreements, that has led to this Court's justifiably frequent grant of certiorari in arbitration cases.

In the banking area, in particular, arbitration clauses appear in savings and checking account agreements, home loan agreements, auto loan agreements, personal loan agreements, credit card agreements, and various ancillary investment and other agreements entered into between banks and consumers. In one study of consumer-initiated arbitration, for example, 90% of the arbitrations reviewed were related to consumer lending in one form or another, and of those arbitrations, 75.2% were related to the banking industry, including claims regarding insurance linked to credit cards, savings and checking account transaction disputes, disputes over credit card charges, interest rates, and payments, mortgage lending disputes, and other claims involving financial services. Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 7-8 (2004).[2]

Such arbitration agreements are of great value to the banking industry as well as to consumers. Indeed, the Ernst & Young study found that arbitration in the consumer lending context had recognized advantages over litigation in connection with outcomes, process, costs, and timeliness. *Id.* at 2. The study further found that consumers prevailed more often than businesses in cases that went to an arbitration hearing, consumers prevailed close to 80% of the time when pre-hearing settlements were taken into account, and that nearly 70% of the consumers surveyed were either satisfied or very satisfied with the arbitration process. *Id.*

The widespread use of arbitration agreements in the banking industry and elsewhere in the economy, and this Court's frequent consideration of cases involving the FAA, amply attest to the national importance of the uniform and certain treatment of cases under the FAA. The decision below

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[2]Available at http://www.ey.com/global/download.nsf/US/-Outcomes_of_Arbitration/$file/OutcomesofArbitrationAnEmpirical-Study.pdf.

threatens such uniformity and certainty and is thus a proper and useful subject for this Court's plenary review.

B. The Issue Presented Arises Frequently and Has Spawned Conflict and Confusion in the Courts.

Given the frequent and widespread use of arbitration clauses, it should come as no surprise that the specific issue raised by the petition likewise arises in numerous cases and spawns conflicting results and rules among the lower courts. Contracts containing arbitration clauses are frequently subject to claims that the underlying contract is illegal for some alleged substantive conflict with law or public policy that has nothing to do with the arbitration clause itself. Under the decision of the Florida Supreme Court below, such claims when brought in state court would automatically supercede the arbitration clause and be resolved by the court rather than the arbitrator. In the federal courts, such claims would properly be left to the arbitrator in the first instance.

The petition notes the split between the decision below and six federal circuit courts of appeals. *See* Pet. 2, 9-10. The majority of the cases identified as part of the split arose in the precise same context – pay-day lending – and involved the precise same claim of illegality – alleged violation of usury laws – at issue in the decision below. But that exposition of the conflict is just the tip of the iceberg.

Numerous other cases in a variety of business contexts likewise have divided on the issue of whether claims of illegality and voidness based on the non-arbitration provisions of a contract should be resolved by the court or an arbitrator. Indeed, the issue has arisen in connection with, *inter alia*:

- Construction contracts, *John B. Goodman Ltd. Partnership* v. *THF Constr., Inc.*, 321 F.3d 1094, 1096-97 (CA11 2003) (voidness alleged based on performance by an unlicensed contractor; issue to be resolved by arbitrator); *Silver Dollar City, Inc.* v. *Kitsmiller Constr. Co.*, 874 S.W.2d 526, 536 (Mo. Ct. App. 1994) (alleged voidness or revocability of entire

1994) (alleged voidness or revocability of entire contract; issue to be resolved by court, not arbitrator)

- Energy industry sales contracts, *Mesa Operating Ltd. Partnership* v. *Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 244 (CA5 1986) (voidness alleged based on violation of state regulations for sale of certain gas; issue to be resolved by arbitrator);
- Franchise agreement contracts, *Nature's 10 Jewelers* v. *Gunderson*, 648 N.W.2d 804, 805 (S.D. 2002) (voidness based on violation of franchise law; issue resolved by court and refusal to enforce arbitration provision);
- Securities brokerage account agreements, *Fazio* v. *Lehman Bros., Inc.*, 340 F.3d 386, 394-95 (CA6 2003) (voidness based on alleged criminal embezzlement and fraud relating to the investment accounts; issue to be resolved by arbitrator);
- Intra-business indemnification agreements, *National R.R. Passenger Corp.* v. *Consolidated Rail Corp.*, 892 F.2d 1066, 1070-71 (CADC 1990) (voidness alleged due to conflict with public policy regarding accountability for illegal acts causing injury; issue to be resolved by arbitrator in first instance); and
- Commercial sales and marketing agreements between telecommunications companies, *R.P.T. of Aspen, Inc.* v. *Innovative Communications, Inc.*, 917 P.2d 340, 342 (Colo. Ct. App. 1996) (voidness alleged based on violation of antitrust laws; issue to be decided by court, not arbitrator).

The above are a mere sampling of cases showing that the issue of arbitrability of allegedly void contracts occurs in disputes far beyond the particular context of pay-day lending. Rather, the issue extends across a wide range of industries and contracts and encompasses a multitude of reasons for claiming that the underlying contract is void.

Furthermore, that the split at issue here is primarily one between the federal and state courts, including federal and state courts having overlapping geographic jurisdiction, makes it all the more important for this Court to resolve the issue. As this Court has noted in a slightly different, though fully analogous, context, divergent rules in federal and state courts would "encourage and reward forum shopping," and Congress certainly did not intend "to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted." *Southland Corp.* v. *Keating*, 465 U.S. 1, 15 (1984). Allowing lesser respect for arbitration agreements in state court than in federal court "would frustrate Congressional intent to place '[a]n arbitration agreement ... upon the same footing as other contracts, where it belongs.'" *Id.* at 15-16 (citation omitted).

Given the variety of industries, contracts, and claims that would be affected by the decision below and by the split in general, the question presented by the petition is of substantial importance and necessitates this Court's review.

II. THE DECISION BELOW IS ERRONEOUS AND IS AN EXAMPLE OF THE VERY HOSTILITY TOWARD ARBITRATION THAT THE FAA WAS ENACTED TO FORECLOSE.

The decision below incorrectly determined that the severability of arbitration clauses was a matter of state, rather than federal law, and did so out of a seeming hostility to arbitration in general. Such a determination is both incorrect and disrespectful of the supervening federal policy and law favoring arbitration agreements and designed to counter precisely such hostility to non-judicial fora for dispute resolution.

A. Arbitration Clauses Are Severable from the Underlying Contract and May Not Be Challenged by Claims that Do Not Independently Question the Making of the Arbitration Agreement Itself.

Petitioner correctly points out that only challenges to the "making" of the arbitration clause itself, not merely challenges to the contract as a whole, are questions for the court prior to compelling arbitration. Pet. 1-2. The distinction between claims relating to the making of the arbitration agreement (such forgery of a signature or lack of authority or competence to sign at all) versus the alleged substantive illegality of some provision of the underlying agreement having nothing to do with the arbitration clause itself, is amply made in the petition and need not be repeated. What does bear expansion, however, is the issue of severability, only briefly touched upon in the petition itself. Pet. 8-9.

As a matter of federal law, arbitration clauses are deemed to be separate and severable agreements from the underlying contracts in which they may appear. *See Prima Paint*, 388 U.S. at 402-04 (describing the then-existing split on the "separability" or "severability" of arbitration clauses and then siding with the Second Circuit's separability position by holding that, when deciding whether to stay proceedings in order for arbitration to proceed, "the statutory language does not permit the federal court to consider claims of fraud in the inducement of the *contract generally*" "a federal court may consider *only issues relating to* the making and performance of *the agreement to arbitrate*") (emphasis added); *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402, 410 (CA2 1959), *cert. granted*, 362 U.S. 909, *dismissed under Rule 60*, 364 U.S. 801 (1960) (treatment of "the agreement to arbitrate as a separable part of the contract is based not only upon the clear wording of the text [of § 2 of the FAA] but is buttressed by several other pertinent considerations" including the historical treatment of arbitration clauses "as separable parts of the contract").

Such severability means that challenges arising only in relation to some aspect of the contract other than the arbitration provision itself might well render the remainder of the contract illegal or unenforceable, but may not be allowed to undermine the arbitration clause itself. It is only claims that *necessarily* challenge the validity of the arbitration clause (whether or not such claims also challenge the contract as a whole) that are properly decided by the court in the first instance.

For example, a claim that a party never signed the agreement at all, or that his signature was forged, independently challenges the making of the arbitration agreement and would be a proper challenge to such arbitration regardless of what the remainder of the contract said. While such a claim would *also* challenge the validity of a contract as a whole, it is its independent effect on the agreement to arbitrate that matters and acts as a prior deficiency notwithstanding any severance of the arbitration agreement from the remainder of the contract. An unsigned arbitration agreement would be invalid whether viewed in conjunction with or separately from the remainder of the underlying contract. A separate arbitration agreement, however, would *not* be subject to a claim of *usury* or other illegality unrelated to the arbitration clause itself. Where validity turns on some *substantive* defect in the terms or performance of the other parts of the contract, separating out the challenged portion of the contract would indeed leave a valid arbitration agreement.

Such a severability requirement is essential to implementing the policies of the FAA, as this Court recognized in *Prima Paint*. The essential lesson of *Prima Paint* was not related to whether a contract was void or merely voidable, but rather whether the alleged defect in the contract inherently or independently undermined the making of the arbitration agreement itself, *separately* considered on its own terms and not as a mere ancillary part of the contract as a whole.

C. The Decision Below Effectively Nullifies Arbitration Clauses and Places State Hostility to Arbitration Ahead of Federal Law Favoring Arbitration.

By shifting the resolution of claims of substantive illegality to the courts and away from arbitrators, the decision below renders arbitration clauses effectively meaningless in such cases. Even where a court ultimately rejects the claim of illegality, that issue will often have been the primary or sole issue in the case and a subsequent order to arbitrate will either be pointless or worse.[3] The pretense that substantive challenges to the underlying contract somehow call into question the validity of the arbitration clause merges together the very separate questions of substance and *forum*. But those issues are inherently distinct given that claims of substantive illegality could readily be made to an arbitrator and there is no reason to think that arbitrators would be incapable of resolving such claims fairly and expeditiously.

Precluding the arbitration of claims of voidness is doubly problematic in that it not only undermines the use of arbitration, but is done out of an open distrust of the arbitration process itself. Such animus towards arbitration is in direct conflict with the policy of the FAA.

The court below, for example, claimed that it was unwilling to allow an arbitrator to decide the issue of illegality because "Florida public policy and contract law prohibit breathing life into a potentially illegal contract." Pet. App. 7a. But treating arbitration agreements as separate and severable con-

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[3] Should an unsuccessful litigant seek to reassert the alleged illegality before an arbitrator and deny that the prior resolution by the court is binding on the ultimate merits, the defending party will, at a minimum, be forced into the further expense of arbitrating the issues of *res judicata* or law-of-the-case and, if somehow unsuccessful on those issues, could be forced to re-litigate the substantive claim itself. Such a duplication of effort undermines the very purpose of arbitration clauses and the very value that Congress saw in arbitration when enacting the FAA.

tracts would not "breathe life" into the potentially offending remainder of the agreement – not unless you improperly presumed that arbitrators would systematically reach the *wrong* result and tend to uphold illegal contracts. In fact, the concurrence is quite explicit in such improper disparagement of the arbitration process. Pet. App. 11a (Bell, J., specially concurring) ("The state's regulatory authority in the consumer protection area could be severely weakened if predatory lenders are allowed to circumvent the state courts and direct to arbitration claims that their lending practices violate state law."). The notion that state consumer protection will suffer from arbitration necessarily depends on the improperly hostile predicate that arbitrators are either biased or incompetent to decide such issues and will improperly rule against consumers.

Arbitration, however, is presumptively neutral toward state consumer protection and will produce results for or against the consumer depending on the specific merits of each case. (If anything, arbitration seems to be a *more favorable* forum for consumers than the courts themselves, particularly in the consumer lending context. *See supra*, at 5.) If the arbitrator agrees that the contract is illegal, he would rule accordingly and deny the illegal contract any effect. Allowing an arbitrator to reach that decision gives no effect to the illegal underlying contract, but rather properly treats it as severable from the arbitration agreement itself. It is only in the limited scenario where the arbitrator erroneously upholds an illegal contract that Florida public policy is even remotely at risk. But in such circumstances, there are other means of vindicating state policy. For example, the resulting arbitral decision could be challenged in court on the grounds that it requires the performance of some illegal act. *National R.R. Passenger Corp.*, 892 F.2d at 1071.

Florida's unwillingness to allow the arbitrator to make the decision in the first instance thus reflects a wholly unwarranted distrust of the arbitration process and the assumption

that arbitrators will reach the wrong results and somehow skew disproportionately against Florida public policy. Not only is that assumption simply wrong as a factual matter (and unsupported by anything in the Florida Supreme Court's opinion), it is also an impermissible basis for avoiding arbitration as a matter of federal law regardless of how state public policy might fare on average in arbitration.

Given the drastic adverse effect of the decision below on the use and benefits of arbitration, and the manifest hostility toward federal policy displayed by the Florida Supreme Court, it is important that this Court resolve the question presented in the petition and give uniform and certain effect to Congressional policy choices and the commands of the FAA.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

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Dated: May 23, 2005.

(2)

Supreme Court, U.S.
FILED
MAY 23 2005
OFFICE OF THE CLERK

No. 04-1264

In the
Supreme Court of the United States

Buckeye Check Cashing, Inc., et al.,

Petitioners,

v.

John Cardegna, et al.,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of the State of Florida

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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INTRODUCTION

In *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), this Court held that when two parties have agreed to arbitrate disputes arising out of a contract, and one party raises a defense against the enforceability of the entire contract (as opposed to the arbitration clause in particular), that the arbitrator – not the court – should resolve the challenge to the enforceability of the entire contract. Petitioners Buckeye Check Cashing, Inc. *et al* ("Petitioners" or "Buckeye") claim that the decision of the court below contradicts the holding of *Prima Paint*. Petitioners claim that the plaintiffs' argument in this case that the contract between the parties was illegal – indeed, that it was criminal – under Florida law, is a contract defense to a contract that has already been legally formed, and that since the defense relates to the entire contract (and not just the arbitration clause), that this defense should have been decided by an arbitrator, and not by the court.

Petitioner's argument is wrong for several reasons. First, Buckeye conveniently overlooks a central premise that underlay this Court's holding in *Prima Paint*: "the purpose of Congress [in enacting the Federal Arbitration Act ("FAA")] in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so." 388 U.S. at 404 n. 12. While Buckeye tends to suggest that this Court was establishing a new federal law of contract enforcement that should find that it is easier for parties to create an agreement to arbitrate than it is to form other types of contracts, this is not correct. In *Prima Paint*, there was no dispute that the parties had formed an agreement to arbitrate. There only question in *Prima Paint* was whether one party might be able to assert a defense against that agreement. As this Opposition will explain, the situation in this case is entirely different. Plaintiffs' arguments in this case go

to the creation of the contract in the first instance, and thus are very different from the contract defense at issue in *Prima Paint*.

Second, Petitioners ignore another subsequent line of decisions from this Court, that inform the way that *Prima Paint* must be understood. In these cases, this Court has repeatedly stated that agreements to arbitrate are subject to generally applicable principles of contract law. *See, e.g., Allied-Bruce Terminix Co.'s, Inc. v. Dobson*, 513 U.S. 265, 281 (1995). Petitioners ignore generally applicable principles of state contract law, and rely upon the hope that this Court will create a new doctrine of contract law that applies only to agreements to arbitrate.

In the decision below, the Florida Supreme Court followed this Court's guidance in both *Prima Paint* and the subsequent cases. Under generally applicable principles of Florida law that date back more than 100 years and that have been repeatedly applied in cases that have nothing to do with arbitration, no contract is ever formed, and no contract ever comes into existence, from an agreement to perform a criminal act. App. at 7a-8a. Accordingly, as the Court below correctly recognized, App. at 5a-6a, *Prima Paint* does not speak to this situation. Petitioners repeatedly state that the doctrine barring the enforcement of illegal agreements is a contract defense, rather than a doctrine of contract formation. *E.g.*, Pet. at 11. In making this assertion, Petitioners simply misunderstand core principles of contract law. The doctrine that criminal contracts are void *ab initio* is thus fundamentally different from the law relating to *voidable* contracts. The latter body of law relates to a defense to a contract that has been formed, not whether a contract has ever come into existence in the first place.

In this case, plaintiffs allege a colorable claim that Petitioners are loan sharks that charge outrageous interest rates that violate Florida's criminal laws. Indeed, one of the consumer plaintiffs in this case was charged interest of over 1,300%. Accordingly, the court below faithfully applied this Court's guidance and held that where, as here, there is an issue under generally applicable principles of state contract law as to whether a contract was formed in the first instance, this gateway question must be resolved by a court.

As the Petition reflects, Petitioners do not like the normal principles of state law relating to contract formation. Instead, Petitioners would like this Court to declare that federal law overrides normal state laws relating to illegal contracts that are void *ab initio*. In demanding this result, Petitioners would have this Court re-write the principles applicable to the formation of all contracts, so that documents that would not form a contract in any other circumstance would form an enforceable contract if they contained an arbitration clause. Petitioners would have this Court delve into (and re-write) normal state law principles governing contract formation.

As the Court below noted, App. at 8a, Petitioners' position would lead to absurd results. Under Petitioners' logic, courts would be required to find that legally cognizable contracts existed (if they contained arbitration clauses) even if they provided for murder-for-hire, the sale of child pornography or the sale of illegal drugs. Under Petitioners' approach, documents establishing such relationships that contained agreements to arbitrate would have to be enforced to the extent of the arbitration clause, notwithstanding generally applicable state contract law to the contrary.

Petitioners' position also would lead to incoherence in contract law. Even Petitioners acknowledge that no arbitration contract comes into existence if there is no assent to that contract. Pet. at 11. To make this admission concrete, imagine a case where there is an allegation that Party A has forged Party B's name on a document that contains an arbitration clause. Petitioners would concede that a court, not an arbitrator, should and would decide whether the allegation of forgery was true. Nonetheless, Petitioners insist that questions of assent are the *only* type of contract formation question that a court, as opposed to an arbitrator may decide. According to Petitioners, all other questions that states might consider to be ones of contract formation under their generally applicable law of contracts – questions that go to whether a contract has come into existence in the first place – are reserved for the arbitrator. Pet. at 11-12. Petitioners' argument not only contradicts the FAA as interpreted by this Court, but leads to anomalous results. The FAA simply does not preempt some parts of normal state law relating to contract formation (those parts relating to assent), while nonetheless preempting other portions of state law relating to contract formation (those portions that are not consistent with Petitioners' interests, as loan sharks).

This case also does not merit this Court's intervention because the nature of the issue raised will affect very few disputes, in very few jurisdictions.

STATEMENT OF THE CASE AND OF THE FACTS

This action was brought by respondents Cardegna and Reuter ("Plaintiffs") on behalf of a class of Florida consumers against Petitioners Buckeye Check Cashing, Inc. and Buckeye

Check Cashing of Florida Inc. and unknown entities and individuals (collectively "Petitioners"or "Buckeye"). The Plaintiffs allege an unlawful scheme in which Buckeye, under the guise of what it falsely portrayed as a check cashing service, in reality charged and collected unconscionably usurious interest from thousands of customers for consumer loans through systematically repeated violations of Florida's Lending Practices Act, Chapter 687, Florida Statutes; Florida's Consumer Finance Act, Chapter 516, Florida Statutes; Florida's Deceptive and Unfair Trade Practices Act, Chapter 501, Part II, Florida Statutes; and Florida's Civil Remedies for Criminal Practices Act, Chapter 772, Florida Statutes.

Buckeye loaned money to its customers in exchange for a written document in the form of a personal check, and a form agreement to repay money in an amount larger than the borrower received within a short period of time, usually two to four weeks. These loans were then continued through loan extensions or roll-over transactions. In each transaction, the Plaintiffs gave Buckeye a personal check and agreed that the face value of the check would be paid within a short time period, usually two weeks. In exchange, Buckeye gave the Plaintiffs cash in an amount less than the face value of the check. In each transaction, Buckeye agreed to hold the check until the next payday or until the customer received her or his next social security or other government check.

Customers unable to repay these loans when due were permitted to extend their debt or roll-over their loans with Buckeye by paying "service fees" when they became due, usually every two weeks. In each transaction, once the Plaintiffs paid the "fee" to Buckeye, then Buckeye would again

forbear collection of the debt. The "fee" on each extension was interest for allowing Plaintiffs and members of the class to defer payment on the original extension of credit. The rate of interest charged by Buckeye on each initial transaction and on each rollover ranged from approximately 137% to 1,317% A.P.R., and the rate was usually over 300% A.P.R.

The plaintiffs here allege that the essence of the transaction is loaning money at highly usurious rates of interest and that the contracts were criminal on their face. In another case currently pending, the Florida Supreme Court is considering whether these transactions are loans. *McKenzie Check Advance of Fl. v. Betts*, No. SC04-1825. If that Court rejects the claims of McKenzie plaintiffs, that will render the instant case moot.

In any case, the plaintiffs here case allege that the policy of the State of Florida to protect its needy citizens from predatory lenders is set out in Chapter 687 of the Florida Statutes, which provides felony sanctions for such lending practices. The threshold for criminal usury is 25% per annum at which point violations constitute a first degree misdemeanor, § 687.071(2), Fla. Stat.(2001). Loaning money at an interest rate in excess of 45% per annum. is a third degree felony. § 687.071(3), Fla. Stat.(2001). Lending money at either the misdemeanor or felony levels of usury is defined as "loan sharking." § 687.071(1)(f), Fla. Stat.(2001). The instant agreements provide for interest rates as high as twenty-nine times the felony threshold!

REASONS FOR DENYING THE PETITION

I. THE DECISION BELOW IS CONSISTENT WITH THE DECISIONS OF THIS COURT.

A. The Decision Below is Consistent With this Court's Guidance that Arbitration Clauses Are Subject to State Laws Applicable to All Contracts.

1. This Court Has Directed That Arbitration Clauses Are Governed By Generally Applicable State Law.

The FAA contains a savings clause that subjects arbitration clauses to the same state contract laws that apply to other types of contracts. This Court repeatedly has stressed that arbitration clauses are governed by state, not federal, contract law except in those instances where state contract laws target arbitration clauses for treatment that is inferior to other types of contracts. Indeed, this Court has noted that the rules of state contract law provide the primary source of protection for consumers against corporate over-reaching in cases governed by the FAA.[1]

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[1] *See, e.g., Allied-Bruce Terminix Co's, Inc. v. Dobson*, 513 U.S. 265, 281 (1995) ("In any event, § 2 gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of any contract.'"). *Cf., First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) (courts "should apply ordinary state-law principles that govern the formation of contracts"); *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989) ("the interpretation of private contracts is ordinarily a question of state law").

This Court has recently reiterated the importance of state contract law under the FAA's scheme. In *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402 (2003), the bank argued that the FAA preempted South Carolina's state contract laws as they applied to the question of whether an arbitration could proceed as a class action. The decision rejected the federal preemption argument and stated that the question of contract interpretation is "a matter of state law. . . ." 123 S. Ct. at 2405.[2]

The Court below held that Florida's generally applicable law relating to illegal and void *ab initio* contracts applies to arbitration clauses. This is hardly an unusual position. There are numerous illustrations of courts applying generally applicable state contract law to arbitration clauses, even when the application of those laws will bar the enforcement of a given arbitration clause. For example, the generally applicable rule of contract law that ambiguities in contracts will be interpreted against the drafter will be applied to arbitration clauses, even where it results in not requiring a party to arbitrate her or his claims. *See, e.g., Victoria v. Superior Court*, 222 Cal. Rptr. 1 (1985), *reh'g denied* (1986); *Dumais v. American Golf Corp.*, 299 F.3d 1216, 1219-20 (10th Cir. 2002); *Quigley v. KPMG*

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[2] This Court also held that the contract interpretation question was a matter for the arbitrator to decide. This is not surprising, given that there was an agreement by both parties that the arbitration contract was legal and binding. The Court stated that "The question here . . . [does not] concern . . . the validity of the arbitration clause. . . ." 123 S. Ct. at 2407. "Rather the relevant question here is what kind of arbitration proceeding the parties agreed to. That question does not concern a state statute or judicial procedures, . . . [i]t concerns contract interpretation and arbitration procedures. Arbitrators are well situated to answer that question." *Id.* This case, by contrast, involves both the validity of the arbitration clause and a state statute.

Peat Marwick, LLP, 749 A.2d 405,416 (N.J. Super. Ct. App. Div. 2000). Similarly, the generally applicable rule of contract law that specific contract provisions will govern over general provisions applies to disputes over the construction of arbitration clauses, for example, even when it has the effect that a party will not be required to arbitrate her or his claims. *See, e.g., Transit Casualty Co. in Receivership v. Certain Underwriters at Lloyd's of London*, 963 S.W.2d 392, 399 (Mo. Ct. App. 1998). Finally, the generally applicable rule of contract law that unconscionable contracts will not be enforced applies to arbitration clauses, and while the vast majority of arbitration clauses are enforced by courts, courts have refused to enforce part or all of particularly abusive arbitration clauses that were grossly one sided and that explicitly or effectively stripped individuals of important rights.[3]

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[3] *See, e.g., Murray v. United Food & Comm. Workers Int'l Union*, 289 F.3d 297 (4th Cir. 2002); *Banc One Acceptance Corp. v. Hill*, 367 F.3d 426 (5th Cir. 2004); *McMullen v. Meijer*, 355 F.3d 485 (6th Cir. 2004); *Popovich v. McDonald's Corp.*, 189 F. Supp.2d 772 (N.D. Ill. 2002); *Gourley v. Yellow Transp., LLC*, 178 F. Supp. 2d 1196 (D. Colo. 2001); *Camacho v. Holiday Homes, Inc.*, 167 F. Supp. 2d 892 (W.D. Va. 2001); *Armendariz v. Foundation Health Psychcare Services, Inc.*, 99 Cal. Rptr. 2d 745 (2000); *Worldwide Inc. Group v. Klopp*, 603 A.2d 788 (Del. 1992); *Iwen v. S. West Direct*, 977 P.2d 989 (Mont. 1999); *D.R. Horton, Inc. v. Green*, 96 P.3d 1159 (Nev. 2004); *Williams v. Aetna Finance Co.*, 700 N.E.2d 859 (Ohio 1998); *Carll v. Terminix Int'l Co., L.P.*, 793 A.2d 921 (Pa. Super. Ct. 2002); *Taylor v. Butler*, 142 S.W.3d 277 (Tenn. 2004), *cert. denied*, 125 S.Ct. 1304 (2005); *In re Turner Bros. Trucking Co., Inc.*, 8 S.W.3d 370 (Tex. Ct. App. 1999); *Sosa v. Paulos*, 924 P.2d 357, 262 (Utah 1996); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265 (W.Va. 2002).

2. Florida Law Providing That Illegal Contracts Are Void *Ab Initio* Is Longstanding and Generally Applicable Law.

As the Court below held, "Florida's law has long held that contracts which are determined to be against public policy and void should not be enforced." App. at 7a. This statement of law is entirely consistent with generally applicable principles of Florida contract law. Contracts which violate Florida criminal laws and public policy are illegal and void *ab initio* and cannot be enforced:

> The right to contract is subject to the general rule that the agreement must be legal and if either its *formation* or its performance is criminal, tortious or otherwise opposed to public policy, the contract or bargain is illegal. *See* 11 Fla. Jur.2d, Contracts 81, Restatement of the Law, Contracts 512. . . . Where a statute imposes a penalty for an act, a contract founded upon said act is considered void in Florida.

Thomas v. Ratiner, 462 So.2d 1157, 1159 (Fla. 3rd DCA 1984), *reh'g denied* (1985) (emphasis in original).

Notwithstanding Petitioners' amplified rhetoric, Pet. at 16, this is hardly a new body of law that arises from a hostility to arbitration. Indeed, all standard texts acknowledge the general principle that an agreement that is void *ab initio* is one that "has at no time had any legal validity." Blacks Law Dictionary (6th ed. 1991). *See also* Restatement 2d Contracts § 7 ("A promise for breach of which the law neither gives a remedy nor otherwise recognizes a duty of performance by the promissory

is often called a void contract. Under § 1, however, such a promise is not a contract at all; it is the 'promise' or 'agreement' that is void of legal effect."). On a number of occasions, moreover, this Court has reached the same conclusions on this basic question of contract law. It is particularly incongruous for Buckeye to claim that federal law preempts Florida contract law providing that courts may enforce no part of void *ab initio* contracts, because Florida law is entirely consistent with this Court's own jurisprudence on the subject. This Court has held, for example, that no court will lead its assistance in any way towards carrying out the terms of an illegal contract. *McMullen v. Hoffman*, 174 U.S. 639 (1899). This Court has also held that illegal promises will not be enforced in cases controlled by federal law. *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 102 S. Ct. 851, 70 L.Ed.2d 833 (1982). There is no indication that the FAA was intended to disrupt this fundamental principle.

Under general principles of Florida contract law (like the law elsewhere), the rule against the enforcement of void contracts is not a partial one that selectively invalidates parts of contracts. Instead, it is an absolute rule that invalidates void contracts in their entirety. "[I]t must be held that as a matter of law any contract made in violation of [the Act's] terms, provisions or requirements is void and confers **no enforceable rights** on the contracting parties." *Umbel v. Foodtrader.Com, Inc.*, 820 So.2d 372, 374 (Fla. 3rd DCA 2002) (emphasis added) (citing *Edwards v. Trulis*, 212 So.2d 893, 895 (Fla. 1st DCA 1968) and *Buehler v. LTI Int'l, Inc.*, 762 So.2d 530 (Fla. 2d DCA 2000)).

In cases arising in entirely different contexts, the Florida Supreme Court has explained in some detail the corrosive effect upon the entire legal system of treating an illegal contract as merely voidable, rather than void:

> If we were to hold a Florida contingent fee contract entered into by a person or attorney who is not a member of The Florida Bar to be voidable rather than void, we would be recognizing the validity of a contract entered into by an attorney not subject to our regulations. This would afford viability to an unregulated contract of the very kind that we have determined to be in the public interest to regulate. *The Florida Bar-In re Amendment to the Code of Professional Responsibility Contingent Fees*, 349 So.2d 630, 632 (Fla. 1977). Additionally, recognizing such an agreement would be directly contrary to the reasons we have expressed for prohibiting the unauthorized practice of law. *Sperry v. Florida ex rel. Florida Bar*, 140 So.2d 587, 595 (Fla. 1962), *rev'd on other grounds*, 373 U.S. 379 (1963).

Chandris, S.A. v. Yanakaksis, 668 So.2d 180, 185 (Fla. 1995), *reh'g denied* (1996).

Under generally applicable Florida contract law, therefore, an agreement which itself violates Florida's public policy and criminal law and is illegal is void *ab initio*; no valid agreement ever comes into existence in the first place.

B. The Decision Below Is Consistent With the *Prima Paint* Decision.

1. *Prima Paint* Involves Contracts that Are Voidable, And Not Contracts that Are Void *Ab Initio*.

Buckeye does not present any authority denying that generally applicable Florida contract law renders criminal contracts void ab initio. Instead, Buckeye effectively argues that an exception to this rule exists for arbitration clauses, suggesting that arbitration clauses are subject to a special and separate set of rules from other types of contract terms. Buckeye derives this proposition from the FAA and this Court's decision in *Prima Paint*, 388 U.S. 395. According to Buckeye, under *Prima Paint* no Court may consider whether Buckeye's contract is illegal and void *ab initio*, because that is a decision for the arbitrator. Pet. at 2. Buckeye's position is flatly wrong.

Buckeye's reading of *Prima Paint* ignores the crucial distinction between a void and voidable contract. Buckeye keeps insisting, without providing any basic contract law authority for the proposition, that the doctrine refusing to recognize illegal contracts is not a doctrine relating to contract formation. Pet. at 11-12. Buckeye further insists that the distinction between voidable contracts and void ab initio contracts is one without a difference. Pet. at 1. These arguments can only be advanced if one disregards core principles of contract law.

A voidable contract, unlike a void *ab initio* contract, is "one where one or more parties have the power, by a

manifestation of election to do so, to avoid the legal relations created by the contract, or by ratification of the contract to extinguish the power of avoidance." Restatement 2d Contracts § 7. With a voidable contract, a valid contract has come into legal existence, although it is possible that one party might successfully defend against its enforcement. For example, under Florida law, "[i]t is axiomatic that fraudulent inducement renders a contract voidable, not void." *Mazzoni Farms, Inc. v. E.I. DuPont DeNemours & Co.*, 761 So.2d 306, 312 (Fla. 2000).

As set forth above, under Florida contract law (like the law in most if not all other states), a contract that is fraudulently induced is merely voidable; a valid contract exists, but is potentially subject to a defense from one party. In such a setting, enforcing the arbitration clause so that the arbitrator may decide this defense is entirely consistent with generally applicable contract law. Contracts that are void *ab initio* pose an entirely different situation. A void *ab initio* contract never comes into existence, and no part of such a contract may ever be enforced by a court, and thus no arbitration clause ever comes into existence. There is nothing to arbitrate. Petitioner misreads the *Prima Paint* rule to sanction the extreme result of requiring a court to enforce an arbitration clause that is embedded in and part of a contract with a singularly illegal purpose and which is, in and of itself, illegal and void.

Judge Easterbrook of the U.S. Court of Appeals for the Seventh Circuit has stressed the importance of this factor: "Fraud in the inducement does not negate the fact that the parties actually reached an agreement. *That's what was critical in Prima Paint*. But whether there was *any* agreement is a

distinct question." *Sphere Drake Ins. Ltd. v. All American Ins. Co.*, 256 F.3d 587 (7th Cir. 2001) (first emphasis added, second in original). Because Buckeye ignores this fact, properly described by Judge Easterbrook as "critical," Buckeye's proposed extension of *Prima Paint* misunderstands that case, misunderstands federal arbitration law, and is simply wrong.

2. The Decision Below Is Consistent With this Court's Direction that Arbitration Clauses Be Placed On the Same Footing as Other Contracts.

Petitioner effectively insists that *Prima Paint* requires courts to treat arbitration clauses are different than any other terms to any contract. As set forth above, Florida's generally applicable rules of state contract law provide that illegal contracts are void *ab initio*, meaning that they never come into existence in the first place. Buckeye argues that among all types of contracts, arbitration clauses alone are exempt from this longstanding body of Florida law, because the FAA supposedly preempts Florida's contract law.

This Court has repeatedly rejected such an approach, however. In interpreting the FAA, this Court has repeatedly given meaning to the language of the Savings Clause and instructed that federal policy regarding arbitration is simply one of enforcing contracts and that the FAA does no more or less than place arbitration agreements on the same footing as other agreements. For all of its discussion of *Prima Paint*, Buckeye never addresses the crucial part of that opinion which undermines all of Buckeye's arguments here. See page 1, *supra*, citing 388 U.S. at 404 n. 12.

In *Equal Employment Opportunity Comm'n v. Waffle House, Inc.*, 122 S. Ct. 754 (2002), similarly, the Court refused to enforce an arbitration provision in an employment contract in a case where claims were asserted by a federal agency that was not a party to that contract. In the *Waffle House* case, the lower court had effectively treated arbitration clauses as some sort of super contract especially favored under federal law. This Court rejected the notion that the FAA embodied a policy goal that would form arbitration agreements in circumstances where no other type of contract could be formed. 122 S. Ct. at 764. Instead, this Court directed, the FAA requires courts to place arbitration agreements on equal footing with other contracts, but it does not require parties to arbitrate when they have not agreed to do so.' *Id.* at 764 (*quoting Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)).

This Court also stressed that arbitration clauses are to be treated the same as other contracts in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996). In *Casarotto*, the Court held that the FAA preempted a state statute that imposed specific disclosure requirements applicable only to arbitration agreements. The Court echoed its earlier decisions in explaining that, through the FAA, Congress precluded states from singling out arbitration provisions for suspect treatment, requiring instead that such provisions be placed upon the same footing as other contracts. *Id.* at 687 (internal quotation omitted). *See also Allied-Bruce Terminix Co., Inc. v. Dobson*, 513 U.S. 265, 281 (1995):

> States may regulate contracts, including arbitration clauses, under general contract law

> principles and they may invalidate an arbitration clause upon such grounds as exist at law or in equity for the revocation of *any* contract. 9 U.S.C. 2 (emphasis added). What states may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal footing, directly contrary to the Act's language and Congress' intent.

Petitioner's arguments rely upon the implicit and faulty notion that the FAA preempts generally applicable state contract laws, as they apply to arbitration. Indeed, Petitioners re-write *Prima Paint* into a federal preemption case. This suggestion conflicts with the remainder of this Court's preemption jurisprudence. As this Court has recognized, however, "[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Volt Info. Sciences*, 489 U.S. at 477. Therefore, the FAA can only displace state law through the doctrine of implied conflict preemption. *Id.* at 477-78. In order to establish that the FAA impliedly preempts Florida's contract law relating to void *ab initio* contracts, Buckeye must demonstrate that there is an "actual conflict" between federal and state law, either because it is "impossible for a private party to comply with both . . . requirements" or because the state laws "stand[] as an obstacle to the accomplishment and execution of full purposes" of Congress. *Freightliner Corp. v. Myrick*, 514 U.S. 280, 287 (1995) (citations omitted). Implied conflict

preemption cannot lie here because the FAA contains no independent rules of federal law for governing these questions of contract law.

C. Petitioners' Proposed Rule of Law Would Lead to Anomalous and Absurd Results.

Generally applicable principles of Florida contract law – like the law in other states – define and give meaning to the phrase void *ab initio*. As set forth above, any contract that is void *ab initio* is not even a contract, and never comes into existence in the first place. This section will discuss a number of cases that support the logic of the decision below, and that even Petitioners acknowledge are correctly decided. In their unprincipled effort to distinguish these cases, Petitioner argues that the FAA requires that states contort their law of contracts in an illogical way. According to Petitioners, the FAA provides that certain types of void *ab initio* contracts (such as those with an unauthorized signature) may be treated as all void *ab initio* contracts have been treated for more than 100 years, but that for no principled reason, parts of other types of void *ab initio* contracts (such as illegal contracts) must be recognized by courts and forced (at least to the extent of any arbitration clause).

As the Court below noted, App. at 6a, and as even Petitioner has acknowledged, Pet. at 11, a host of courts have refused to extend *Prima Paint*'s holding to cases involving allegations that no contract ever came into existence in the first place. These courts have held that this latter type of allegation by definition implicates the making of the agreement for arbitration and therefore must be decided by a court as a

precondition to any arbitration order under the FAA. A particularly important precedent is *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99 (3rd Cir. 2000) (Becker, J.). While *Sandvik* did not involve an illegal contract, the court's analysis of the importance of the distinction between void and voidable contracts closely tracks the logic employed by the Florida Supreme Court in this case. In *Sandvik*, the Third Circuit held that a party cannot enforce an arbitration clause while denying that it is bound by the contract containing that clause because, "[e]ven under the severability doctrine [of *Prima Paint*], there may be no arbitration if the agreement to arbitrate is non-existent." *Id.* at 101. The Third Circuit construed *Prima Paint* as applying only to allegations that would render a contract *voidable*, and held that courts must resolve all allegations that would render an entire contract (and therefore its arbitration clause) *void*:

> Mindful of the doctrine announced in *Prima Paint*, which did not consider a situation in which the *existence* of the underlying contract was at issue, we draw a distinction between contracts that are asserted to be void or non-existent, as is contended here, and those that are merely voidable, as was the contract at issue in *Prima Paint*, for purposes of evaluating whether the making of the arbitration agreement is in dispute.

Id. at 107.

Several other courts have followed the same analysis as *Sandvik* in holding that courts, not arbitrators, must evaluate challenges that an entire contract never came into valid

existence in the first place. In *Sphere Drake*, for example, the Seventh Circuit faced the question of whether an arbitrator or a court should resolve allegations that the person who signed a contract on behalf of one party had the authority to make that commitment. The party attempting to enforce the arbitration clause invoked *Prima Paint*, and claimed that this was a generalized challenge to the entire contract that the arbitrator should resolve. Focusing on the difference between void and voidable contracts, the Seventh Circuit rejected this claim, and held that the question was one for the court:

> This is not a defense to enforcement, as in *Prima Paint*; it is a situation in which no contract came into being; and as arbitration depends on a valid contract an argument that the contract does not exist can't magically be resolved by the arbitrator (unless the parties agree to arbitrate this issue after the dispute arises).

Sphere Drake, 256 F.3d at 591.

In *Chastain v. Robinson Humphrey Co., Inc.*, 957 F.2d 851 (11th Cir. 1992), similarly, the court held that a court, not an arbitrator must decide allegations that a signature to a contract was forged. The Eleventh Circuit focused on the difference between arguments that are contract defenses and arguments that go to the existence of a contract:

> The calculus changes when it is undisputable that the party seeking to avoid arbitration has not signed any contract requiring arbitration. In such a case, that party is challenging the very existence of *any*

> agreement, *including the existence of an agreement to arbitrate*. Under these circumstances, there is no presumptively valid general contract which would trigger the district court's duty to compel arbitration pursuant to the Act.

Chastain, 957 F.2d at 854. *See also Three Valleys Municipal Water Dist. v. E.F. Hutton & Co., Inc.*, 925 F.2d 1136, 1140 (9th Cir. 1991) (court decides whether signatory to contract had authority to bind party, we read *Prima Paint* as limited to challenges seeking to *avoid* or *rescind* a contract not to challenges going to the very existence of a contract) (emphasis in original); *I.S. Joseph Co., Inc. v. Michigan Sugar Co.*, 803 F.2d 396 (8th Cir. 1986) (court decides whether assignee can enforce contract).

The cases relied upon by Buckeye, by contrast, fragment state contract law in indefensible ways. This is illustrated by one of Buckeye's leading cases. In *Bess v. Check Express*, 294 F.3d 1298 (11th Cir. 2002), the Court acknowledged that arbitration clauses are not to be enforced when they are embedded in contracts that are void *ab initio* because one party did not have the authority to sign the contract. The Court then implicitly created a new rule of federal law (in an area plainly to be governed by state law), that illegal contracts are subject to a different rule because the issue of illegality only goes to "the *content* of the contracts, not their *existence*." *Bess*, 294 F.3d at 1305 (emphasis in original). The *Bess* opinion never explains the rationale or cites any authority for this conclusory statement. Florida's generally applicable contract law is to the contrary. Buckeye never challenges this conclusion as to Florida law. Given that *Bess*'s characterization of illegality as unrelated to

the existence of a contract is simply wrong as a matter of contract law, *Bess*'s holding relies upon the mistaken conclusion that federal law preempts and overrides a state's generally applicable and longstanding rules of contract law.

Buckeye gives no convincing explanation for why the Congress, when it passed the FAA in 1925, could have possibly intended to honor generally applicable state law as to contracts that are void *ab initio* in some settings but to sweep it aside in others.

Petitioners' insistence that arbitration clauses are somehow above or exempt from this well-established body of law could readily lead to absurd results. Imagine hypothetical contracts for the sale of cocaine, or the making of child pornography, or a murder-for-hire, that included (a) a liquidated damage provision; and (b) an arbitration agreement. Obviously such contracts would violate any number of criminal laws and be void *ab initio*. No legal agreement has ever come into being and no court or arbitrator could order or otherwise authorize performance - any performance - under the contract. Similarly, it is obvious that no court would, could or should ever enforce the liquidated damages provision. Under the position advocated by Buckeye, however, the arbitration clause is somehow different from and better than all other provisions in this wholly illegal contract, and the arbitration clause would be enforced. Indeed, under Petitioner's position, any question concerning the illegality of the entire contract would be one that only the arbitrator could adjudicate. These hypotheticals demonstrate the extreme and unjustified nature of Buckeye's position.

D. Petitioners' Position Also Is Contrary to this Court's Direction in *Howsam* that Gateway Questions Relating to the Existence of an Arbitration Clause Are for the Court, Not the Arbitrator.

Petitioners' position also conflicts with this Court's decision in *Howsam v. Dean Witter*, 537 U.S. 79, 123 S. Ct. 588 (2002). In *Howsam*, this Court unsurprisingly held that an arbitrator, not a court, should determine whether a party violated an arbitration rule. After all, as the Court noted, "the NASD arbitrators, comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it." *Howsam*, 123 S. Ct. at 593. There was no question that the parties were bound by a legally valid arbitration agreement, however, and this Court explained that disputes on *that* question are for the court. "[A] gateway dispute about whether the parties are bound by a given arbitration clause raises a 'question of arbitrability' for a court to decide." 123 S. Ct. at 592. This case involves precisely the type of "gateway question" that this Court has said is for the court, not the arbitrator.

Petitioner asserts repeatedly that there are six federal courts of appeal that support its position and conflict with the decision below. *E.g.*, Pet. at 2. It is notable, however, that only one of those decisions came after this Court handed down *Howsam*. The only exception is *Jenkins v. First Am. Cash Advance of Ga., LLC*, 400 F.3d 868 (11th Cir. 2005), and that case offers no convincing explanation of how its ruling could be consistent with *Howsam*.

II. THIS CASE DOES NOT PRESENT AN ISSUE WORTHY OF CERTIORARI.

Buckeye employs a great deal of high octane rhetoric about how the entire structure of the FAA will come undone if courts rather than arbitrators decide the question of whether a contract is illegal. *See* Pet. at 15. This argument ignores the unique nature of the allegations in this case. The rather unusual allegations in this case argue that Buckeye's contracts violated Florida's *criminal* laws, and that Buckeye was engaged in felonious loansharking.

This sort of issue rarely arises in civil cases. Civil plaintiffs regularly argue that some particular conduct of a defendant breaks a contract or gives rise to a remedy under some remedial statute, but it is quite rare to encounter a civil plaintiff arguing that an entire line of business operated contrary to the rule of law and is per se illegal. It is particularly rare to see a case, such as this, where there are substantive arguments that the entire enterprise is *criminal*. A ruling for the plaintiffs here will have no effect upon traditional banks, or any other legitimate business enterprise. A ruling for the plaintiffs here will only impact upon businesses whose contracts are wholly illegal, such as the loanshark defendants here, or the cocaine sellers or child pornographers hypothesized above. The ruling of the court below is highly unlikely, as a practical matter, to be applicable in many cases. It is hard to perceive how the decision could apply to the activities of credit card issuers, for example: their operations are not generally even arguably criminal(as normal lenders never charge interest rates of 300% to 1,300%). In short, the ruling below is likely to largely only relate to the payday lending industry.

In short, the issue posed by this case is unlikely to recur often. Petitioners ask this Court to find that an arbitration clause embedded in a criminally illegal contract is not subject to generally applicable state contract law providing that illegal contracts are void *ab initio* and thus never come into existence in the first place. The self-evident fact is that Buckeye's rhetoric about the grave nature of the assault on the architecture of the FAA is greatly exaggerated.

CONCLUSION

For all the reasons set forth above, this Court should deny the Petition for certiorari.

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Date: May 23, 2005

SUPREME COURT
FILED
MAY 27 2005
OFFICE OF THE CLERK

(16)

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Florida

REPLY TO BRIEF IN OPPOSITION

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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INTRODUCTION

Respondents cannot, and do not, deny that the Florida Supreme Court's decision below, like the Alabama Supreme Court's decision in *Alabama Catalog Sales v. Harris*, 794 So. 2d 312 (Ala. 2000), conflicts with the decisions of no fewer than six federal courts of appeals. Rather, respondents insist that the decision below is correct on the merits, and that the contrary federal appellate cases are "mistaken," "indefensible," and "simply wrong." Opp. 21-22. Although respondents themselves are incorrect on that score, the key point for present purposes is that the opposition brief implicitly underscores that this Court's review is warranted: in respondents' view, six federal courts of appeals have erroneously decided an important issue of federal law in a manner squarely inconsistent with the highest courts of two States. If ever an opposition brief made the case for a grant of certiorari, this is it.

I. Respondents Provide No Reason To Deny Review.

Respondents devote the first 23 pages of their 25-page opposition brief to arguing that the decision below is correct, and that the contrary federal appellate authorities are incorrect. Respondents are certainly entitled to that opinion, however misguided, but their insistence on arguing the merits provides no reason for this Court to deny review. To the contrary, respondents expressly acknowledge that the decision below conflicts with two recent decisions by the Eleventh Circuit, *Jenkins v. First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 880-82 (11th Cir. 2005), and *Bess v. Check Express*, 294 F.3d 1298, 1304-06 (11th Cir. 2002), *see* Opp. 21-23, so that plaintiffs in Florida (or, for that matter, Alabama, in light of *Alabama Catalog Sales*) can avoid arbitration by filing in state, rather than federal, court. Needless to say, that conflict—if left unreviewed—would "encourage and reward forum shopping" antithetical to the Federal Arbitration Act ("FAA"). *Southland Corp. v. Keating*, 465 U.S. 1, 15 (1984). Federal arbitration rights are effectively worthless if they can be defeated by

forum-shopping. Accordingly, this Court should grant certiorari to resolve the conflict.

Other than insisting that they are correct on the merits, respondents' only objection to certiorari is the passing suggestion, made in the final page-and-a-half of their brief, that "the ruling below is likely to largely only relate to the payday lending industry." Opp. 24. That argument, as the various *amicus* briefs underscore, is manifestly incorrect.

Under the decision below, a plaintiff can avoid an arbitration agreement by simply challenging the underlying contract as illegal—on *any* ground. That approach is by no means limited to payday advance contracts; rather, it is limited only by the imagination of the plaintiffs' bar. The United States Chamber of Commerce, the Florida Bankers Association, and the American Bankers Association understand this point perfectly well; that is why they have urged this Court to grant the petition. A sizeable chunk of all arbitrations in this country involve consumer lending agreements, and virtually all such agreements can be challenged as usurious or otherwise in violation of a maze of state and/or federal laws, including the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, and the Fair Credit Billing Act, 15 U.S.C. § 1666. Indeed, in this highly regulated day and age, virtually *all* contracts—from construction contracts to energy sales contracts to franchise agreements—can be (and have been) challenged as illegal. *See* FBA/ABA *Amicus* Br. 6-7. The Florida Supreme Court's decision below, like the Alabama Supreme Court's earlier decision to the same effect, thus effectively strips defendants of their federal arbitration rights by allowing plaintiffs to defeat those rights at will by challenging the underlying contract (but not the arbitration clause itself) as illegal on any ground.

There is nothing "unusual" about the payday advance business, Opp. 24, that changes any of the above. Respondents' assertion that petitioner is not a "legitimate business

enterprise," *id.*, is manifestly incorrect. The payday advance business is not only lawful in Florida (as well as other States), but is heavily regulated by both state and federal law. *See* CFSA *Amicus* Br. 6-7. Under Florida law, a payday advance is a deferred presentment transaction, not a loan subject to state usury laws. *See* Fl. Stat. §§ 560.402-04. Accordingly, respondents cannot claim that the transactions at issue here violate current Florida law; at most, they can claim (erroneously) that the transactions violated Florida law *prior* to the enactment of the Deferred Presentment Act, Fl. Stat. § 560.401 *et seq.*, in 2001.[1] Respondents' assertion that this "entire line of business operated contrary to the rule of law and is per se illegal," and their attempt to equate payday advance businesses with "cocaine sellers or child pornographers," Opp. 24, is thus as baseless as it is offensive.[2]

---

[1] The Florida intermediate appellate courts are divided on whether payday advance transactions executed *prior* to the enactment of the Deferred Presentment Act in 2001 are loans governed by state usury laws. *Compare Betts v. Ace Cash Express, Inc.*, 827 So. 2d 294, 297 (Fla. Dist. Ct. App. 2002) (holding that such transactions are not loans governed by state usury laws) *with Betts v. McKenzie Check Advance of Florida, LLC*, 879 So. 2d 667, 672-74 (Fla. Dist. Ct. App. 2004) (holding that such transactions are loans governed by state usury laws). As respondents note, *see* Opp. 6, the Florida Supreme Court is now considering that issue on the merits. *See McKenzie Check Advance of Fl. v. Betts*, Fla. S. Ct. No. SC04-1825 (review granted Sept. 17, 2004). Respondents err, however, by suggesting in passing that "[i]f that Court rejects the claims of McKenzie plaintiffs, that will render the instant case moot." Opp. 6. The only issue presented here is whether the trial court correctly denied petitioner's motion to compel arbitration. No resolution of *McKenzie* (which does not involve arbitration) could "moot" that issue. Petitioner has not even moved to dismiss respondents' claims on the merits. Thus, regardless of how *McKenzie* is decided, this case will remain alive for resolution of the threshold question of *who decides* here whether the challenged transactions are illegal—an arbitrator or a court.

[2] Respondents' description of petitioner's business in Florida is also replete with false or misleading statements. For example, it is simply untrue that petitioner permitted its customers "to extend their debt or roll-over their loans ... by paying 'service fees' when they became due," Opp. 5, since

II. Respondents Are Wrong On The Merits.

Because respondents cannot offer any reason for this Court to deny review of the conflict noted above, they devote the bulk of their efforts to arguing that the Florida Supreme Court is correct on the merits, and that the six federal appellate courts to have concluded otherwise are all wrong. As noted above, that argument misses the point, because the only issue presented here is whether this Court should grant review in the first place. Nonetheless, respondents' merits-based arguments deserve a brief response.

Respondents repeat over and over again the mantra that an illegal contract is void *ab initio*, as if that proposition decided the issue in this case. It does not: as Justice Cantero explained in dissent below, "[t]he issue in this case is not whether a check-cashing contract is void as usurious," but "*who decides* whether the contract is void—the arbitrator, as provided in the contract itself, or the court." Pet. App. 13a (emphasis in original). Accordingly, respondents (like the Florida and Alabama Supreme Courts) simply beg the question by insisting that a court cannot compel arbitration because the underlying contract is allegedly illegal. Under the FAA, the validity of an arbitration clause is severable from the validity of the underlying contract as a matter of federal law. *See Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967). Thus, the task of a court presented with a motion to compel arbitration under the FAA is sharply limited: the court must determine whether there is any challenge to the making of the agreement to arbitrate. *See id.* If so, the court must resolve that challenge; if not, the court must compel arbitration. *See id.*

---

petitioner never permitted "roll-overs" in Florida, and thus charged no such fees. Because these factual issues have no bearing on the legal issue presented here, however, petitioner will not burden this Court with a point-by-point refutation.

Respondents (like the Florida and Alabama Supreme Courts) thus miss the point by insisting that the key issue here is whether the underlying contract is voidable or void under state law. The FAA draws no such distinction; to the contrary, as *Prima Paint* makes clear, the FAA draws a distinction between challenges that go to the making of an arbitration agreement and those that do not. *See id.* In some cases, an allegation that the underlying contract is void may implicate the making of an arbitration agreement—*i.e.*, an allegation that the entire contract was forged, or signed by a signatory without authority. *See, e.g., Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001); *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 110 n.9 (3d Cir. 2000); *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851, 855 (11th Cir. 1992); *Three Valleys Municipal Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1139-42 (9th Cir. 1991). In other cases, however, an allegation that the underlying contract is void does *not* implicate the making of an arbitration agreement—*i.e.*, an allegation that the underlying contract violates some state or federal law. *See, e.g., Jenkins*, 400 F.3d at 880-82; *Bess*, 294 F.3d at 1304-06; *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 636-38 (4th Cir. 2002); *Burden v. Check Into Cash of Ky., LLC*, 267 F.3d 483, 489-90 (6th Cir. 2001); *Harter v. Iowa Grain Co.*, 220 F.3d 544, 550 (7th Cir. 2000); *3H & Assocs., Inc. v. Hanjin Eng'g & Constr. Co.*, No. 97-16751, 1998 WL 657722, at *2 (9th Cir. Sept. 3, 1998) (unpublished); *Lawrence v. Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1161-62 (5th Cir. 1987). The void/voidable distinction is thus unhelpful in deciding the only question that really matters under *Prima Paint*: whether the challenge goes to the making of an agreement to arbitrate.

Respondents finally argue that "[p]etitioners' position also conflicts with this Court's decision in *Howsam v. Dean Witter*, 537 U.S. 79" (2002). Opp. 23. That argument is, quite simply, bizarre. *Howsam* took a *broad* view of what issues are to be

decided by an arbitrator, as opposed to a court, and held that the issue in that case (whether a dispute was "eligible for submission to arbitration" on timeliness grounds) should be decided by the arbitrator. *See* 537 U.S. at 83-85. Respondents assert that *Howsam* helps them because it recognized that courts must resolve gateway "'questions of arbitrability.'" Opp. 23 (quoting 537 U.S. at 83-84). But *Howsam* made clear that the realm of gateway "questions of arbitrability" for a court to decide is extremely narrow. *See* 537 U.S. at 84-85. If anything, the question whether an underlying contract is illegal is even more obviously *not* a gateway "question of arbitrability" than the "eligib[ility] for submission to arbitration" question at issue in *Howsam* itself. Thus, *Howsam* only confirms petitioner's argument that allegations of illegality in the underlying contract (as opposed to the arbitration clause) must be decided by an arbitrator, not a court, and thus provide no basis for denying a motion to compel arbitration.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for writ of certiorari.

Respectfully submitted,

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May 27, 2005

Supreme Court, U.S.
FILED
Aug 12 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ of Certiorari to the Supreme Court of Florida

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED MARCH 21, 2005
CERTIORARI GRANTED JUNE 20, 2005

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FIFTEENTH JUDICIAL CIRCUIT OF FLORIDA

Report Selection Criteria

Case ID: 502001CA001162XXOCAJ
Docket Start Date:
Docket Ending Date:

Case Description

Case ID: 502001CA001162XXOCAJ
Case Caption: JOHN A CARDEGNA V BUCKEYE CHECK CASHING
Division: AJ - BARKDULL
Filing Date: Thursday, February 01st, 2001
Court: CA - CIRCUIT CIVIL
Location: MB - MAIN BRANCH
Jury: Y - Jury
Type: OC - OTHER CIRCUIT
Status: AS - REDISPOSED

Filing Date	Docket No.	Docket Text
2/01/01	1	(COMPLAINT); JR.-NOJR/CT-NOCT = Y W/ATTACHMENTS
		***
3/20/01	10	(NOTICE OF REMOVAL TO FEDERAL COURT); COMPANY NAME IS BUCKEYE CHECK CASHING INC DBA CHECKSM TO U.S. DISTRICT COURT FOR SOUTHERN DISTRICT OF FLORIDA.

		W.P.B., DIV., WITH COPY OF SAME ATTCHED HERETO; (UPDATE/CHANGE OR CORRECT CASE STATUS ONLY) KM
04/02/01	11	(LETTER OF CORRESPONDENCE) TO CHERYL L. MARTONE, DTD 3/30/01, RE: ATTACHED COPY OF ORDER OF REMAND BACK TO FIFTEENTH JUDICIAL CIRCUIT CT.; (UPDATE/CHANGE OR CORRECT CASE STATUS ONLY) KM
		***
04/06/01	13	(NOTICE) OF DEFT, BUCKEYE CHECK CASHING, INC., OF REFILING OF ANSWER TO COMPLAINT, W/COPY OF SAME ATTACHED HERETO
04/06/01	14	(MOTION TO COMPEL) OF DEFT, BUCKEYE CHECK CASHING, INC., ARBITRATION AND STAY PROCEEDING, W/ATTACHED MEMORANDUM OF LAW & EXH. "A"
04/06/01	15	(MOTION FOR PROTECTIVE ORDER) OF DEFT, BUCKEYE CHECK CASHING, INC., STAYING DISCOVERY UNTIL AFTER RESOLUTION OF BUCKEYE'S MOTION TO COMPEL ARBITRATION,

		W/ATTACHED MEMORANDUM OF LAW & EXH. "A"
		***
07/05/01	23	(BRIEF) (SUPPLEMENTAL) OF DEFT, BUCKEYE CHECK CASHING, INC., IN FURTHER SUPPORT OF ITS MOTION TO COMPEL ARBITRATION AND STAY PROCEEDING
07/16/01	24	(MEMORANDUM) OF PLTFS, JOHN A. CARDEGNA AND DONNA REUTER, IN OPPOSITION TO DEFT CHECKSMART'S MOTION TO COMPEL ARBITRATION AND STAY LITIGATION PENDING ARBITRATION (CT NOT A TO FILE)
08/06/01	25	(LETTER OF CORRESPONDENCE) TO JUDGE BARKDULL, FROM E. CLAYTON YATES, DTD 8/02/01 RE: PROPOSED ORDER DENYING DEFT'S MOTION TO COMPEL ARBITRATION (CT NOTA TO FILE)
08/06/01	26	(ORDER) DENYING DEFT BUCKEYE CHECK CASHING, INC.'S MOTION TO COMPEL ARBITRATION AND STAY PROCEEDING. SEE ORDER FOR DETAILS. DTD 8/06/01 T BARKDULL

08/31/01	27	(NOTICE OF NON FINAL APPEAL); BOOK NUMBER = 12887 PAGE NUMBER = 00155; COMPANY NAME IS BUCKEYE CHECK CASHING INC DBA CHECKSM; ATTORNEY NAME IS JOHN R HART; NBR OF PAGES = 00007 TO 4DCA ORDER RENDERED 8/6/01 -COPY ATTACHED- CC 4DCA 8/31/01 W/CK#9121. MC
		***
09/11/01	29	(ACKNOWLEDGMENT FROM 4TH DCA) APPEAL FILED 8/31/01 GIVEN 4DCA CASE NO. 4D01-3549 AND IS A NON-FINAL APPEAL
		***
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10/03/02	34	(MOTION); NBR OF PAGES = 00000 OF DFT, BUCKEYE CHECK CASHING, INC., FOR AN ORDER COMPELLING ARBITRATION & STAYING PROCEEDINGS CONSISTENT W/THE 4TH DISTRICT COURT OF APPEAL'S RULING, WITH ATTCHD TABS 1 THRU 3
		***

10/22/02	36	(ORDER); NBR OF PAGES - 00000 COMPELLING ARBITRATION AND STAYING PROCEEDINGS. MOTION IS GRANTED. ACTION REFERRED TO ARBITRATION, ALL PROCEEDINGS ARE STAYED PENDING COMPLETION OF ARBITRATION.
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03/14/05	38	FROM SUPREME COURT OF FLORIDA SC02-2161 3/3/05 4DCA NO. 4D01-3549 RESPONDENT'S MOTION FOR STAY OF PROCEEDING IS HEREBY GRANTED AND PROCEEDINGS IN THIS COURT, 4DCA & CIRCUIT CT ARE HEREBY STAYED TO & INCLUDING 4/4/05. TO ALLOW RESPONDENT TO SEEK REVIEW IN THE SUPREME CT AND OBTAIN ANY FURTHER STAY FROM THAT COURT. W/COURT NOTATION TO FILE.

U.S. District Court

Southern District of Florida (W. Palm Beach)

CIVIL DOCKET FOR CASE #: 01-CV-8236

Cardegna, et al v. Buckeye Check, et al

Filed: 03/20/01
Assigned to: Judge Daniel T. K. Hurley
Jury demand: Defendant
Demand: $0,000
Nature of Suit: 890
Jurisdiction: Federal Question
Dkt # in 15 Judicial Circuit : is CL 01-1162AJ
Cause: 28:1441 Notice of Removal - Injunctive/Declaratory Relief

Date	No.	Docket Entry
03/20/01	1	NOTICE OF REMOVAL from: 15th Judicial Circuit FILING FEE $150.00 RECEIPT #714138 (pa) [Entry date 3/22/01]
03/27/01	2	MOTION by Buckeye Check to compel Arbitration, and to stay Proceeding (rh) [Entry date 03/28/01]
03/27/01	3	APPENDIX to: [2-1] motion to compel Arbitration by Buckeye Check (rh) [Entry date 03/28/01]
03/27/01	4	MOTION by Buckeye Check for protective order Staying Discovery until after resolution of

		Buckeye's Motion to Compel Arbitration (rh) [Entry date 03/28/01]
03/27/01	5	ANSWER to Complaint by Buckeye Check (Attorney John R. Hart) (rh) [Entry date 03/28/01]
		***
03/28/01	7	ORDER REMANDING CASE TO FIFTEENTH JUDICIAL CIRCUIT IN And FOR PALM BEACH COUNT, [*sic*] FLORIDA ADN [*sic*] CLOSING CASE: ORDER remanding case to Fifteenth Judicial Circuit in and for Palm Beach County, Florida and Closing file The Clerk of the court shall close the case, deny any pending motions as moot, and send a certified copy of this order to the Clerk of the Fifteenth Judicial Circuit in and for Palm Beach County, Florida (signed by Judge Daniel T. K. Hurley on 3/27/01) CCAP [EOD Date: 3/30/01] (pa) [Entry date 03/30/01]

Fourth District Court of Appeal Case Docket

Case Number: 4D01-3549

Non-Final Civil Other Notice from Palm Beach County

BUCKEYE CHECK CASHING, INC. vs.
JOHN A. CARDEGNA, et al.

Lower Tribunal Case(s): CL 01-1162 AJ

Date Docketed	No.	Description
09/04/01	2	Notice of Appeal Filed
		***
10/01/01	8	Initial Brief on Merits
10/01/01	9	Appendix
		***
11/13/01	13	Motion For Cases to Travel Together
11/19/01	14	Grant Miscellaneous Motion
11/28/01	15	Appellee's Answer Brief
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07/24/02	29	Reversed - Authored Opinion
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09/20/02	36	Mandate
10/03/02	37	NOTICE OF DISCRETN. JURISDICTN
10/04/02	38	Review Sent to Supreme Court
		***
04/07/05	43	Supreme Court Disposition
		***
04/08/05	45	Upon Mandate of the Supreme Court

Florida Supreme Court Case Docket

Case Number: SC02-2161 - Closed

JOHN A. CARDEGNA, ET AL. vs. BUCKEYE CHECK CASHING, INC., ETC.

Date Docketed	No.	Proceeding
10/07/02	1	NOTICE-DISCRETIONARY JURIS (DIRECT CONFLICT)
		***
10/17/02	4	JURIS INITIAL BRIEF
11/08/02	5	JURIS ANSWER BRIEF
		***
04/25/03	10	ORDER-OA&BRIEF SCHED/JURIS ACCEPTED
		***
05/23/03	23	MOTION-AMICUS CURIAE
06/06/03	24	INITIAL BRIEF-MERITS
		***
06/11/03	26	ORDER-AMICUS CURIAE GR
		***
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		***
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		***
01/20/05	65	DISP-QUASHED & REMANDED

IN THE CIRCUIT COURT OF
THE FIFTEENTH JUDICIAL CIRCUIT
IN AND FOR PALM BEACH COUNTY, FLORIDA

JOHN A. CARDEGNA,
and DONNA REUTER
individually and on behalf
of others similarly situated,

Plaintiffs, CASE NO:_____
CLASS REPRESENTATION

vs.

BUCKEYE CHECK CASHING, INC.
a foreign corporation, dba CHECKSMART,
BUCKEYE CHECK CASHING OF FLORIDA, INC.
a foreign corporation dba CHECKSMART
and UNKNOWN ENTITIES AND INDIVIDUALS

Defendants.

COMPLAINT AND DEMAND FOR JURY TRIAL
INJUNCTIVE RELIEF SOUGHT

Plaintiffs, John A. Cardegna ("Cardegna") and Donna Reuter ("Reuter") individually, and on behalf of others similarly situated ("members of the class" or "customers"), through the undersigned counsel, complaining against the Defendants, Buckeye Check Cashing, Inc. ("Buckeye of Ohio") and Buckeye Check Cashing of Florida Inc. ("Buckeye of Florida") (collectively "corporate defendants" or "Checksmart") and unknown entities and individuals (collectively "Defendants"), hereby state as follows:

INTRODUCTION

1. This is a class action brought pursuant to Rule 1.220 of the Florida Rules of Civil Procedure, arising out of a scheme under which the Defendants charged and collected from Plaintiffs and numerous others similarly situated, unconscionable, usurious interest rates for consumer loans through systematic and flagrant violations of state consumer protection laws. Defendants were not licensed to make consumer loans. Defendants, inter alia, illegally collected payment of monies from Plaintiffs and members of the class by directly and indirectly falsely threatening to pursue collection under Florida bad check laws. Plaintiffs seeks [*sic*] injunctive relief and the recovery of statutory damages, civil penalties, actual damages, compensatory damages, litigation expenses and costs and attorneys' fees.

2. Count I of this action alleges that Defendants violated Florida's Lending Practices Act, Chapter 687, Florida Statutes.

3. Count II of this action alleges that Defendants violated Florida's Consumer Finance Act, Chapter 516, Florida Statutes.

4. Count III of this action alleges that Defendants violated Florida's Deceptive and Unfair Trade Practices Act, Chapter 501, Consumer Protection Part II, Florida Statutes.

5. Count IV of this action alleges that Defendants violated Florida's Civil Remedies For Criminal Practices Act, Chapter 772 Florida Statutes.

JURISDICTION AND VENUE

6. This is an action for damages that exceeds $15,000.00.

7. Buckeye of Ohio and Buckeye of Florida are foreign corporations, qualified to do business in the State of Florida. Buckeye of Ohio's registered agent is Corporations Service Company, 1201 Hays St., Tallahassee, Florida 32301-2525. Buckeye of Florida's registered agent is James H. Frauenberg, 1916 Gulf To Bay Rd., Clearwater, Florida 33765. Checksmart

and unknown individuals and entities have knowingly engaged in the business of lending money to consumers at unconscionable usurious interest rates at a business location at 4647 Lake Worth Road, Lake Work, Florida and other locations in Florida.

8. The unknown entities and individuals are subject to the jurisdiction of this Court because they are doing business in the State of Florida, including Palm Beach County, by organizing, developing, managing, controlling, promoting, expanding and directing the unlawful activities of Checksmart. It is anticipated the identities of the unknown entities and individuals will be ascertained within a brief period of time through the discovery process, at which time Plaintiffs will file an appropriate Motion to Add Party Defendants with the Court.

THE PARTIES

9. Plaintiff Cardegna is an individual residing at 6064 Haddon Road, West Palm Beach, Florida 33417. Plaintiff Reuter is an individual residing at 1032 South A Street, Lake Worth, Florida 34950.

10. Defendants, Buckeye of Ohio and Buckeye of Florida, are foreign corporations, located at 6321 Ireland Drive, Dublin, Ohio 43016. Buckeye of Ohio is qualified to do business in Florida and Buckeye of Florida was established and qualified to do business in Florida for the purpose of engaging in the unlawful practices set forth hereinafter and conducting business as Checksmart and other names unknown to Plaintiff within the State of Florida.

11. Entities and individuals unknown to Plaintiffs conceived the idea to engage Checksmart in the business of making consumer loans under the guise of a "check cashing" scheme. Entities and individuals unknown to Plaintiffs organized, developed, controlled, promoted and expanded the unlawful activities of Checksmart and profited therefrom.

12. Unknown individuals incorporated Buckeye of Florida for an illegal purpose, and cannot therefore rely on its corporate shield to protect them for [*sic*] personal responsibility for their act or the acts of Buckeye of Florida.

13. Entities and individual defendants unknown to Plaintiffs have operated and participated in an illegal enterprise by imposing and collecting illegal and usurious interest from Plaintiffs and members of the class.

GENERAL ALLEGATIONS APPLICABLE TO ALL MEMBERS OF THE CLASS

14. Defendants through their various businesses and locations within the State of Florida engaged in a common course of illegal conduct by which, without a consumer loan license, Checksmart loaned money to consumers in exchange for a written document in the form of a personal check ("check") and an agreement to repay money in an amount larger than the borrower received within thirty days, usually within two weeks. This practice is commonly known as payday loans. Customers went to Defendants' businesses to obtain immediate cash for personal use. The same loan service was offered by Defendants and accepted by Plaintiffs and members of the class through a standardized procedure at each of Defendants' locations. Under the guise of what they falsely portrayed as a check cashing service, Defendants loaned money to hundreds, perhaps thousands of consumers in Florida at usurious rates over six (6) times greater than permitted by law.

15. Defendants perpetrated their illegal scheme upon those who used their services through the same methods, practices and procedures, namely (1) money lending transactions which Defendants call "deferred deposit" transactions and (2) "rollover" transactions whereby the "deferred deposit" loans are renewed, continued or extended in any manner.

16. In each initial "deferred deposit" transaction, Plaintiffs and members of the class, as the borrowers, gave Defendants as

lenders a "check" made payable to the borrower. The customer then agreed with Defendants that the face value of the "check" would be paid within a short period of time, usually within two weeks, but occasionally up to 30 days. Checksmart, in exchange for the "check," delivered to the Plaintiffs and other customers an amount less than the face value of the "check." The Defendants knew or reasonably should have known that this business practice constitutes a consumer loan under Florida law.

17. Defendants knew or reasonably should have known at the time the Plaintiffs and members of the class gave their "check" to Defendants that the document was merely evidence of debt, but was used by the Defendants in the nature of security to enforce collection of an unenforceable usurious loan in violation of Florida Statutes 687.04 and 687.071(7). Defendants knew or reasonably should have known that the Plaintiffs and members of the class borrowed money from Defendants because they did not have sufficient funds in the bank to cover the "check."

18. Under the ruse of charging Plaintiffs and the members of the class "service fees," Defendants in reality were charging interest for the use, forbearance or detention of money.

19. Each "check," as written, exceeded the amount of money that was given to the borrower by more than 10% of the loan. For example, in exchange for $150.00, Cardegna had to execute a "check" for $171.66 to be repaid in two weeks. The annual percentage rate ("APR") for the cost of credit to Cardegna for two weeks was 376.47%. The interest charged by Checksmart was called a "fee."

20. Plaintiffs and members of the class were solicited to repeat or extend their loans with Defendants within thirty days and usually within two weeks or less. In each such rollover transaction, once the customer paid the "fee," i.e. the interest, then Defendants would again forbear collection of the debt by

renewing or extending the loan. Defendants regularly permitted customers to obtain additional extensions, including multiple extensions, by paying the additional "fee" with each extension. Defendants employed a subterfuge to collect the rollover interest by requiring the borrower to execute new loan documents with each rollover, and requiring the borrower to pay the interest and principle [*sic*] with each rollover. The principle [*sic*] was immediately returned to borrower as a part of the transaction. The net effect was that the borrower repeatedly paid interest on the initial loan every pay period.

21. Defendants contemplated as part of its business practice that Plaintiffs and members of the class would not be financially able to cover their "check" when payment of the debt was due and would repeat or extend the loan.

22. Each "fee" payment on a rollover transaction was unconscionable, usurious, illegal and violative of the statutes set forth in this Complaint.

23. The unconscionable rate of interest charged by Defendants ranged upward from a 126 percent to 1,317% APR.

24. If customers did not redeem their "checks" by payment of the debt in full, or extend or rollover the debt by payment of an additional "fee," Defendants would deposit customers' "checks." If the "checks" did not clear on presentment, Defendants charged customers with delinquency and check collection charges and, directly and indirectly, threatened to prosecute customers for violations of the Florida law governing dishonored checks. Defendants knew or reasonably should have known that the "checks" did not have the legal effect of checks as defined by Florida Statutes; the "checks" were not payable on demand; the documents were merely evidence of the debt in the nature of a promissory note; that the agreement accompanying the loans, as defined by the Uniform Commercial Code, had created an extension of credit; and that

Plaintiffs and members of the class were not subject to the Florida law governing dishonored checks.

25. Defendants engaged in this course of conduct for the purpose of compelling Plaintiffs and members of the class to pay the usurious interest rate for the extension of credit and to renew or extend their loans.

26. Each loan transaction, including each rollover, was concluded in minutes at minimal cost to Defendants.

27. As a result of the Defendants' conduct the Plaintiffs and members of the class paid illegal, usurious interest.

28. Each class member was harmed in the same way having been falsely induced to enter into an agreement to borrow money and pay usurious, exorbitant and illegal interest rates to their severe detriment and damage.

29. Defendants were not licensed to make consumer loans in the State of Florida prior to the filing of this action.

30. Plaintiffs are advised and aver that Defendants have not, during the period of time material hereto, acted in good faith in reliance upon any duly and lawfully adopted order, declaratory statement or rule issued by the Florida Department of Banking and Finance.

ALLEGATIONS RELATING TO PLAINTIFF CARDEGNA'S TRANSACTIONS

31. In approximately May 1999, Plaintiff Cardegna began doing business with Checksmart at its business location at 2835 North Military Trail, West Palm Beach, Florida, 33405, because he needed money to pay personal bills. Cardegna believes and avers he initially borrowed $150.00 from Checksmart. The amount of his loans were gradually increased to $900.00. Checksmart required him to provide certain information and to sign a document referred to as a "Deferred Deposit and Disclosure Agreement" (see examples attached as Exhibit "A") and execute and deliver a paper document in the form of a

check payable to Checksmart, in an amount larger than the principal sum advanced. For example, in a transaction dated March 17, 2000, Cardegna wrote Checksmart a "check" for $171.66 and he received $150.00. Checksmart agreed to hold the "check" until March 31, 2000, his next payday. On March 30, 2000, Cardegna paid Checksmart $171.66, wrote Checksmart a "check" for $171.66, and Checksmart returned to Cardegna $150.00 of his money. The same loan transaction was repeated on April 13, 2000 and April 27, 2000. See Exhibit A.

32. Checksmart solicited Cardegna to extend or renew his loan, by paying the amount of the debt, pick up his old "check" and write a replacement "check." The new "check" was in the amount of the principle plus interest. Checksmart then returned to Cardegna the principle. For approximately a year Cardegna borrowed money and extended his loans by paying interest in excess of ten percent on each loan and each rollover, and by writing a new "check" each time. (See examples of "checks" and receipts attached with Composite Exhibit "A" hereto).

33. Although the loans to Cardegna were unsecured, Defendants used his "checks" in the nature of security to assure payment. Believing that if his "check" bounced, he would be in violation of the Florida bad check law, Cardegna paid the "fee" every two weeks, often ahead of other household bills.

34. Checksmart concealed the illegal interest charges and the true nature of the transactions.

35. Using the guise as a check casher, Checksmart compelled Plaintiff to pay unconscionable usurious interest rates on his loan. Checksmart knew or should have known that Plaintiff would not have sufficient funds on deposit at the time of the presentation of the "check" to cover the amount he received or the amount for which the paper was written; that the "check" was not payable on demand; that the obligation underlying the "check" was void, illegal and not enforceable as

the "check" was an instrument to carry out an usurious loan with an interest rate in excess of 45% per annum.

36. Documents signed by Cardegna and members of the Class (Exhibit "A) contain an arbitration clause that is void for illegality as an instrument to carry out a usurious loan scheme that is criminal in nature and the arbitration clause is also unenforceable as unconscionable and as a contract of adhesion in the context of a consumer lending transaction.

37. All documents in the possession of Cardegna or his counsel on which this action is brought are attached as Composite Exhibit "A." It is anticipated that additional documents supporting his claims will be obtained through discovery.

ALLEGATIONS RELATING TO PLAINTIFF REUTER'S TRANSACTIONS

38. In approximately May of 2000, Plaintiff Reuter began doing business with Checksmart at its business location at 4647/4649 Lake Worth Rd., Lake Worth, FL 33463, because she needed money to pay personal bills. Reuter, to the best of her recollection initially borrowed approximately $100.00 from Checksmart. The amount of the loan was gradually increased to $400.00. Checksmart required her to provide certain information and to sign a document referred to as a "Deferred Deposit and Disclosure and Disclosure Agreement" (see example attached to composite Exhibit "B") and execute and deliver a paper document in the form of a "check" payable to Checksmart, in an amount larger than the principal sum advanced. For example, the "check" for the $400.00 loan was written for the face amount of $449.44. Checksmart agreed with Reuter to hold the "check" until her next payday, approximately two weeks. In exchange for Reuter's "check," Checksmart advanced Reuter the loan principle. If Reuter did not have sufficient funds in the bank to cover the "check" within two weeks, Checksmart solicited and allowed her to

extend or renew her loan by paying the amount of the check. As part of the transaction, Checksmart would return Reuter's "check" and then rollover the loan by having Reuter write a new "check" in the amount of the principle plus interest. Checksmart then returned to Reuter the principle amount in Cash. For approximately five months Reuter rolled her debt approximately every two weeks by paying a "fee" in excess of ten percent fee [*sic*] for the two week loan and by writing a new "check" each time.

39. Checksmart concealed the illegal interest charges and the true nature of the transactions.

40. Using the guise of operating as a check casher, Checksmart compelled Reuter to pay unconscionable usurious interest rates on her loan. Checksmart knew or should have known that Reuter would not have sufficient funds on deposit to cover the "check," that the "check" was not payable on demand; and that the obligation underlying the "check" was void, illegal and not enforceable as the "check" was an instrument to carry out an usurious loan with an interest rate in excess of 45% per annum.

41. The document signed by Reuter and members of the Class (Exhibit "B") contains an arbitration clause that is void for illegality as an instrument to carry out a usurious loan scheme that is criminal in nature and the arbitration clause is also unenforceable for unconscionability and as a contract of adhesion in the context of a consumer lending transaction.

42. All documents in the possession of Reuter or her counsel on which this action is brought are attached as Composite Exhibit "B," it is anticipated that additional documents supporting her claims will be obtained through discovery.

CLASS REPRESENTATION ALLEGATIONS

43. Plaintiffs brings [*sic*] this class action on behalf of a class of hundreds, and potentially thousands of consumers who

were victimized by the Defendants' illegal course of conduct at its different business locations in the State of Florida. Plaintiffs and all class members were subjected to the same money lending scheme which Defendants perpetrated under the guise of operating as check casher, they were all harmed in the same manner, and they now seek to enforce the same rights and remedies under the same legal theories.

44. The class consists of all persons who received cash in exchange for a personal "check" from the Defendants and paid a "fee" as pat of its business in Florida from four years before the filing of this suit.

45. The class, which includes thousands of persons, is so numerous that separate joinder of all members is impracticable.

46. The claims of the representative party raises questions of law and fact common to the claims of each member of the class, which predominate over any questions affecting individual class members. The common questions of law are:

a. Whether Defendants' businesses were actually a loan operation and the fees charged and collected were interest;

b. Whether Defendants failed to disclose all material and necessary information to Plaintiffs and members of the class.

c. Whether Defendants' collection of interest in excess of two hundred and eighty percent per annum was unconscionable and violated the Florida lawful rate of interest, as set forth in Florida Statutes 516.01 *et seq.*;

d. Whether Defendants were properly licensed to engage in the consumer credit business pursuant to Florida Statutes 516.01 *et seq.*;

e. Whether Defendants violated the Florida Usury Statute, Florida Statutes, 687.03;

f. Whether Defendants violated the Florida Criminal Usury Statues, 687.071;

g. Whether Defendants are liable under Florida's Civil Remedies for Criminal Practices Act, Chapter 772 Florida Statutes.

h. Whether defendants are subject to the usury provisions of Florida Statutes, chapter 687 as a check cashing business.

47. The claims of Cardegna and Reuter are typical of the claims of each member of the class, which all arise from the same operative facts and are based on the same remedial or legal theories.

48. The Plaintiffs will fairly and adequately protect the interests of each member of the class. The Plaintiffs have common interests with unknown members of the class and intent to vigorously prosecute the interests of the class through qualified counsel. Plaintiffs have retained counsel who are experienced in handling class actions and consumer protection cases. Neither Plaintiffs nor Plaintiffs' counsel have any interests which might cause them not to vigorously pursue this action.

49. A class action is a superior method for the fair and efficient adjudication of this controversy. Most of the class members were and still may be unaware of the wrongs perpetrated against them or of their right to legal redress for those wrongs. Although the practices complained of are directed against financially desperate persons unable to protect their rights because individual litigation for such small claims is not economically feasible, Defendants derive large aggregate profits from the complained of violations, making a class action essential. Pursuant to Rule 1.220(b)(1), the prosecution of

separate actions by individual members of the class would create a risk of:

a. Inconsistent or varying adjudications concerning individual members of the class which would establish incompatible standards of conduct for a party opposing the class; and

b. Adjudications concerning individual members of the class which would, as a practical matter, be dispositive of the interest of other members of the class who are not parties to this adjudications [*sic*], or substantially impair or impede the ability of other members of the class who are not parties to the adjudications to protect their interest. In fact, individual members of the class cannot effectively litigate against Defendants or its representatives because of the costs incident thereto.

50. Pursuant to Rule 1.220(b)(2), the Defendants have acted on grounds that are specifically and generally applicable to each potential member of the class thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole.

51. Pursuant to Rule 1.220(b)(3), the questions of law and fact common to the claims of the representative parties and the claims of each member of the class predominate over any questions of law or fact affecting only individual members. All potential class members are easily identifiable through appropriate discovery.

52. Not only is a class action superior to other available methods for the fair and efficient adjudication of this

controversy, but failure to utilize a class action could result in literally thousands of cases being filed in the various courts throughout the State of Florida and federal courts sitting in Florida.

53. After determinations of the legality of the Defendants' conduct, the Court can utilize a simple method of accounting to resolve all potential claims of the Plaintiffs and to resolve all potential claims of members of the class.

COUNT I
VIOLATION OF FLORIDA'S LENDING PRACTICES STATUTES, CHAPTER 687

54. Plaintiffs incorporates [*sic*] paragraphs one through fifty-three.

55. Defendants have made consumer loans to the Plaintiffs and class members in amounts less than $25,000.00.

56. Defendants have charged and collected exorbitant, unconscionable and usurious interest for the use of money, contrary to law.

57. Upon information and belief, Defendants were not licensed to engage in the business of providing consumer credit.

58. Defendants are and were at all relevant times in fact engaged in the business of making consumer loans and imposing and collecting loan charges which were interest.

59. Since Checksmart is not licensed, it is operating in violation of the law and since the interest charged by Defendants is 126% per annum or higher, it is operating in violation of the law.

60. Defendants engaged in unconscionable conduct by taking interest and loan charges in excess of the limitation fixed by 687.02, 687.03, 687.04, and 687.071, Florida Statutes.

61. By the willful and knowing making and renewing or extending loans of money to Plaintiffs and members of the class

as a check cashing service, and the willful and knowing charging and receiving interest at a rate exceeding 45% per annum, Defendants were committing acts of loan sharking or shylocking contrary to Florida Statute 687.071.

62. Unknown individual Defendants willfully and knowingly developed, implemented, controlled and participated in charges and collections of these usurious rates and profited therefrom and should be held personally liable.

63. Defendants are liable to Plaintiffs and members of the class in the sum of double the amount of interest reserved, taken or exacted, a refund of all principal payments made to Defendants, and Defendants must forfeit all unpaid interest and principal.

COUNT II
VIOLATION OF THE FLORIDA CONSUMER FINANCE ACT

64. Plaintiffs incorporate paragraphs one through sixty three.

65. Defendants engaged in the business of making consumer loans in an amount less than $25,000.00 at a rate of interest greater than the rate of interest permitted by law contrary to Florida Statutes, 516.01 *et seq*.

66. On information and belief, Defendants are not qualified and are not licensed by the Florida Department of Banking and Finance to make loans in an amount less than $25,000.00 as required by Florida Statutes, 516.02.

67. Defendants, its agents and employees, did directly and indirectly, by the devices, subterfuge and pretenses heretofore described, charge, contract for and receive a greater rate of interest than provided for by statute for loans in an amount of less than $25,000.00 against the public policy of the State of Florida.

68. Defendants misrepresented to Plaintiffs and class members that their "checks" could be deposited if customers did not pay the debt, or rollover the debt, exposing customers to bad check charges and other consequences of violations of the Florida bad check law; and misrepresented that the transactions were unsecured and at the same time used the "check" as security to enforce payment contrary to Florida Statute 516.07(e).

69. Defendants used unreasonable collection practices and false, deceptive and misleading advertising in connection with the operation of its business to make consumer loans in violation of Florida Statute 516.07(e).

70. Plaintiffs and members of the class were injured as a result of Defendants' violations. Defendants' loans are unenforceable. Plaintiffs and members of the class are entitled to a full refund of all loans collected by Defendants.

COUNT III
VIOLATION OF THE FLORIDA DECEPTIVE AND UNFAIR TRADE PRACTICES ACT

71. Plaintiffs incorporate paragraphs one through seventy.

72. Defendants engaged in false, misleading and deceptive advertising by statements that its business involved cashing a check for a fee, and when it was in fact lending money to consumers at an illegal rate of interest.

73. Defendants violated Florida Statutes, Chapter 501, Part II known as the Florida Deceptive and Unfair Trade Practices Act by intentionally and in bad faith misrepresenting to Plaintiffs and other class members that its money lending business was a deferred deposit type of check cashing business. Specifically these representations include the following:

a. Misrepresenting that loans were deferred deposit type of check cashing services;

b. Misrepresenting that its consumer debts could be collected by the use of the Florida bad check laws;

c. Failure to disclose the total interest rate being charged to borrowers by identifying part of the interest as "deferred deposit origination fee"; and

d. Misrepresenting that loan documents signed by customers were checks.

74. Defendants charged usurious rates in excess of six (6) times the rate permitted. Defendants' business practices contemplated that Plaintiffs and members of the class would not have sufficient funds to pay the principal and interest when due. Defendants expressly and impliedly threatened to charge bad check fees and to prosecute under the bad check law if the "checks" of Plaintiffs and members of the class were not honored on presentment for payment. These acts were unconscionable and unfair trade practices in violation of the Florida Deceptive and Unfair Trade Practices Act.

75. By engaging in specific conduct alleged in the preceding counts of Plaintiffs' Complaint, Defendants committed and continue to commit unfair and deceptive acts and practices in violation of the Florida Deceptive and Unfair Trade Practices Act, Florida Statutes 501.202 *et seq*., including but not limited to:

a. causing likelihood of confusion or of misunderstanding as to the source, sponsorship, approval and/or certification of service;

b. causing likelihood of confusion or of misunderstanding as to the affiliation, connection, association with or certification by another;

c. using deceptive representations in connection with services;

d. representing that services have approval, characteristics, uses and/or benefits that they do not have;

e. representing that services are of a particular standard and quality when they are not;

f. advertising services with intent not to provide as advertised;

g. engaging in fraudulent conduct which creates the likelihood of confusion or of misunderstanding;

h. engaging in conduct which had the intended effect of misleading Plaintiffs and members of the class regarding the nature of services.

76. Defendants are liable for unlawful interest paid as actual damages sustained for each consumer transaction, injunctive relief, attorneys' fees and costs by Florida Statute 501.211 for their willful, malicious, intentional and/or wrongful acts.

COUNT IV

CIVIL REMEDIES FOR CRIMINAL PRACTICES ACT

77. Plaintiffs incorporate paragraphs 1 through 77.

78. Defendants Buckeye of Ohio and Buckeye of Florida and unknown Defendants have formed an association in fact through continuing coordinated conduct including establishment of procedures and management of the unlawful loan business described herein and collection of unlawful debts [as defined in F.S. § 772.103(2)(a)3], which is an enterprise, as that term is defined in Florida Statutes § 772.102(3).

79. *Alternatively*, Defendant, Buckeye of Ohio was an "enterprise" as that term is defined in Florida Statutes § 772.102(3) until such time as Buckeye of Florida began conducting the Florida "deferred deposit" transactions of Buckeye of Ohio and thereafter Buckeye of Florida became the "enterprise."

80. From January 1996 to the present, Defendants engaged in collection of unlawful debt by lending money to Plaintiff and other class members at a criminally usurious rate under Florida law.

81. The collection or attempt to collect the unlawful debt from Plaintiff and other class members was incurred in connection with the enterprise's business of lending money and was unenforceable in whole or in part under Florida laws.

82. Defendants received proceeds derived, directly or indirectly, through the collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3), and used or invested the income, directly or indirectly, to establish, operate and expand the unlawful lending business of the association in fact enterprise, in violation of Florida Statutes § 772.103(1).

83. *Or alternatively*, Unknown Defendants received proceeds, directly or indirectly, through the collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3) and used or invested the income, directly or indirectly, to establish, operate and expand the unlawful lending business of the Buckeye of Ohio enterprise, in violation of Florida Statutes § 772.103(1); and Unknown Defendants and Buckeye of Ohio received proceeds derived, directly or indirectly, through the collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3) and used or invested the income, directly or indirectly, to establish, operate and expand the unlawful lending business of Buckeye of Florida after it became the enterprise, in violation of Florida Statutes violation of [*sic*] § 772.103(1);

84. Defendants, through the collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3) have, directly or indirectly, acquired or maintained an interest in, or control of, the association in fact enterprise, in violation of Florida Statutes § 772.103(2).

85. *Or alternatively,* Unknown Defendants through the collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3), have, directly or indirectly, acquired or maintained an interest in, or control of the Buckeye of Ohio enterprise, in violation of Florida Statutes § 772.103(2)(a)3), have, directly or indirectly, acquired or maintained an interest in, or control of Buckeye of Florida after it became the enterprise, in violation of Florida States § 772.103(3).

86. Defendants were employed by or associated with the association in fact "enterprise" and conducted such enterprise's affairs and obtained income from such enterprise through collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3), from Plaintiff and other class members in violation of Florida Statutes § 772.103(3).

87. *Or alternatively,* Unknown Defendants have associated with the Buckeye of Ohio enterprise and conducted such enterprise's affairs and obtained income from such enterprise through a pattern of collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3), from Plaintiff and other class members in violation of Florida Statutes § 772.103(3); and Unknown Defendants and Buckeye of Ohio have associated with Buckeye of Florida since it became the enterprise and conducted such enterprise's affairs and obtained income from such enterprise through a pattern of collection of unlawful debt (as defined in F.S. § 772.103(2)(a)3), from Plaintiff [*sic*] and other class members in violation of Florida Statutes § 772.103(3).

88. Defendants Buckeye of Ohio and Buckeye of Florida and unknown persons conspired or endeavored to violate Florida Statutes 772.103(1), (2) and (3) by entering into an

agreement to participate in a scheme to create and operate an enterprise to engage in the collection of unlawful debt (as defined by F.S. § 772.103(2)(a)3), all in violation of Florida Statutes 772.103(4).

89. Plaintiff [*sic*] and members of the class have been injured (in the form of usurious interest paid or charged) by Defendants through the collection of unlawful debt, as set out in paragraphs 77 through 88 above.

90. The association in fact being the enterprise, Defendants are liable to Plaintiffs and members of the class for treble damages cumulative to any other remedy, plus costs and attorneys' fees for their violations of Florida Statutes § 772.103 as set out in paragraphs 77 through 88 above; *or in the alternative*, Unknown Defendants are liable to Plaintiffs and members of the class for treble damages cumulative to any other remedy, plus costs and attorneys' fees for their violations of Florida Statutes § 772.103 as set out in paragraphs 77 through 88 above during the period of time that Buckeye of Ohio was the enterprise and Unknown Defendants and Buckeye of Ohio are liable to Plaintiffs and members of the class for treble damages cumulative to any other remedy, plus costs and attorneys' fees for their violations of Florida Statutes § 772.103 as set out in paragraphs 77 through 88 above during the period of time that Buckeye of Florida was the enterprise.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs request the following relief:

a) That the Court make a determination as soon as practicable certifying that this action may proceed as a class action and that the named Plaintiffs may represent the class;

b) That Plaintiffs and members of the class have injunctive relief against the Defendants prohibiting them from continuing to engage in the illegal conduct as alleged;

c) The Defendants be ordered to cease their efforts to collect monies from Plaintiffs and class members;

d) Pursuant to Florida Statutes Chapter 687 and Chapter 516, the transactions between Plaintiffs and members of the class and Defendants be declared void and Plaintiffs and members of the class be awarded all sums paid to Defendants, including but not limited to principal, double interest, and any other fees, including collection costs paid, for each and every transaction;

e) Pursuant to the Florida Deceptive and Unfair Trade Practices Act, Florida Statutes Chapter 501, Part II, that Plaintiffs and members of the class be awarded actual damages, attorneys' fees and costs;

f) Pursuant to the claims under Florida Statutes 772, Plaintiffs and members of the class be awarded treble damages supplemental to damages awarded under any other claim, costs and attorneys' fees;

g) The Plaintiffs and members of the class be awarded expenses, costs, pre-judgment and post-judgment interest;

h) Plaintiffs and members of the class be granted any other relief that the Court may deem appropriate.

JURY TRIAL DEMANDED

Plaintiffs herein demands [*sic*] a jury trial on all issues so triable.

/s/

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4830 West Kennedy Blvd.
Suite 147
Tampa, Florida 33609
813/286-4100
813/286-4174

Richard A. Fisher
LOGAN, THOMPSON, MILLER, BILBO, THOMPSON & FISHER, PC
30 2nd Street
P.O. Box 191
Cleveland, TN 37364-0191
423/ 476-2251
423/ 472-0211

R. KEVIN FISHER
LAW OFFICE OF R. KEVIN FISHER
12424 Wilshire Blvd., Suite 770
Los Angeles, CA 90025
310/820-0772

COUNSEL FOR PLAINTIFFS

BEST AVAILABLE COPY

Buckeye Check Cashing INC.
dba CHECKS$MART
Deferred Deposit and Disclosure Agreement

Today's Date 10-28-99
Name: John A Cardegna
Address: 6064 Adalaide Rd
City: Wms State: FL Zip: 33417
Social Security Number: 262-15-1634

Borrower
Home Phone: 640 7566
Work Phone:
Weekly Net Income:

Check$mart Licensed State of Florida
Deferred Deposits made are subject to State of Florida Authority

#260

19

Itemization of Amount Financed	Annual Percentage Rate	Finance Charge	Amount Financed	Total of Payments
	The cost of your credit as a yearly rate.	Deferred Deposit origination fee plus interest amount	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments
1. Actual Cash You Receive: 500.00				
2. Total Finance Charge: 60.55				
3. Total Note Amount: 560.55	35.73%	$ 60.53	$ 500.00	$ 560.55

(Month) (Day)

Security: Unsecured

Payment Schedule: One Payment in the amount of $ 560.55 Due on 11/11/99.

Promise to Pay: You promise to pay the Deferred Deposit (total of payments, plus any other permitted charge) to the order of Check$mart according to the terms stated herein

Refund for Payment: If, after the first month of the contract, the Deferred Deposit is repaid in full before the final installment payment date, any unearned interest for the unexpired period of the Deferred Deposit contract that follows the date of payment in full will be refunded according to the sum of the digits method sometimes called the "Rule of 78ths," according to applicable law

Finance Charge: The Finance Charge consists of interest and fee only. If interest on this Deferred Deposit is not precomputed, the Finance Charge is computed on outstanding unpaid principal balances on the basis that installments shall have been paid according to the contract. Delinquency will increase the Finance Charge as the contract rate is computed on actual unpaid balances on the amount financed for the actual time outstanding

Prepayment: You may repay this contract in full at any time. However you agree to pay a minimum finance charge of $ as allowed by Florida law, if you pay this contract off before Check$mart has earned that much in Finance Charges with in the first month

Check Collection Charges: You will be charged for any check collection charges made by a financial institution for each check returned or dishonored for any reason upon the same terms and conditions upon which check collection charges are made by the financial institution.

Other Deferred Deposit Transactions: Do you have any deferred deposit transactions outstanding to any deferred deposit service business? Initial ___ YES or ___ NO. If the answer is yes, do you have more than one (1) deferred deposit transactions outstanding? Initial ___YES or ___NO. If the answer is no, what is the face value of the outstanding deferred deposit transaction? $ _____

Other Terms: This contract cannot be assumed by third party without the written consent of Check$mart

CHECKS WILL BE DEPOSITED ON THE DUE DATE ABOVE. TO GUARANTEE AVAILABILITY, CHECKS MUST BE PICKED UP PRIOR TO THIS DUE DATE.

BANKRUPTCY: I DO NOT INTEND TO INCLUDE THIS CHECK IN ANY BANKRUPTCY PROCEEDING. I AM NOT CURRENTLY FILING AND DO NOT ANTICIPATE FILING BANKRUPTCY.

THE FEE CHARGE FOR A DEFERRED DEPOSIT TRANSACTION IS A SERVICE FEE AND NOT INTEREST. THIS DISCLOSURE IS PROVIDED TO YOU PURSUANT TO THE FEDERAL TRUTH IN LENDING ACT, 15 U.S.C. 1601 ET SEQ. AND THE REGULATIONS PROMULGATED THEREUNDER, IN PARTICULAR REGULATION Z, 12 CFR PART 226. THE SERVICE FEES CHARGED FOR THE DEFERRED DEPOSIT TRANSACTION ARE INCLUDED IN THE CALCULATION OF AN ANNUAL PERCENTAGE RATE. THIS DOCUMENT IS FOR DISCLOSURE PURPOSES ONLY AND DOES NOT AFFECT THE CHARACTER OF THE FEES UNDER FLORIDA LAW

I have signed this Deferred Deposit agreement on the date below and acknowledge that I have read it, understand it, and that I have received a complete copy of it.

Borrower's signature John A Cardegna Date 10-28-99

"WARNING: THE RATE OF INTEREST CHARGED ON THIS DEFERRED DEPOSIT AGREEMENT IS HIGHER THAN THE AVERAGE RATE OF INTEREST CHARGED BY FINANCIAL INSTITUTIONS ON SUBSTANTIALLY SIMILAR LOANS."

Customer Service Representative: Please, check the following:

- ☐ Does the customer have a prior Deferred Deposit? Verify that the prior Deferred Deposit has been paid (check has cleared).
- ☐ Verify that the customer's current home and work phone numbers are written above.
- ☐ Update the Customer Information Screen on the Answers System, including your initials and today's date.
- ☐ Verify that the check is written for the total amount of the Deferred Deposit.
- ☐ Verify that the weekly income shown above is not less than the total amount of the Deferred Deposit.
- ☐ Verify that the date the check is written for today's date.
- ☐ Verify that deposit date is the customer's next payday or the following day.

SEE REVERSE FOR STORE LOCATIONS

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[illegible]

[illegible]

[illegible]

Buckeye Check Cashing INC.
dba CHECKS$MART
Deferred Deposit and Disclosure Agreement

Today's Date

Borrower

Name

Address

Home Phone

City State Zip

Work Phone

Social Security Number

Weekly Net Income

Check$mart Licensed State of Florida

Deferred Deposits made are subject to State of Florida Authority

Itemization of Amount Financed	Annual Percentage Rate	Finance Charge	Amount Financed	Total of Payments
1. Actual Cash You Receive	The cost of your credit as a yearly rate	Deferred Deposit origination fee plus interest amount	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments
2. Total Finance Charge	%	$	$	$
3. Total Note Amount				

(Month) (Day)

Security Unsecured

Payment Schedule One Payment in the amount of $ Due on

Promise to Pay: You promise to pay the Deferred Deposit (total of payments, plus any other permitted charge) to the order of Check$mart according to the terms stated herein

Refund for Payment: If, after the first month of the contract, the Deferred Deposit is repaid in full before the final installment payment date, any unearned interest for the unexpired period of the Deferred Deposit contract that follows the date of payment in full will be refunded according to the sum of the digits method sometimes called the "Rule of 78ths," according to applicable law

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I have signed this Deferred Deposit agreement on the date below and acknowledge that I have read it, understand it, and that I have received a complete copy of it.

Borrower's signature Date 5-11-2011

"WARNING: THE RATE OF INTEREST CHARGED ON THIS DEFERRED DEPOSIT AGREEMENT IS HIGHER THAN THE AVERAGE RATE OF INTEREST CHARGED BY FINANCIAL INSTITUTIONS ON SUBSTANTIALLY SIMILAR LOANS."

Customer Service Representive: Please, check the following

- ☐ Does the customer have a prior loan? Verify that the prior loan has been paid (check has cleared)
- ☐ Verify that the customer's home and work phone numbers are written above
- ☐ Update the Customer Information Screen on the Answers system, including your initials and today's date
- ☐ Verify that the check is written for the total amount of the loan
- ☐ Verify that the weekly income shown above is not less than the total amount of the loan
- ☐ Verify that the date the check is written for is the date that the check will be deposited
- ☐ Verify that deposit date is the customer's next payday or the following day

SEE REVERSE FOR STORE LOCATIONS

TERMS AND CONDITIONS

1. Arbitration Disclosure. By signing this Agreement, you agree that if a dispute of any kind arises out of this Agreement or your application therefore or any instrument relating thereto (than either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below. If arbitration is chosen, it will be conducted with the American Arbitration Association (the "AAA") pursuant to the AAA's Commercial Arbitration Rules. If you have any questions concerning the AAA or if you wish to obtain a copy of the AAA's Commercial Arbitration Rules, you may call (800) 339-4777 or visit http://www.adr.org on the World Wide Web.

2. Arbitration Provisions. Any claim, dispute or controversy (whether in contract, tort or otherwise, whether pre-existing, present, or future, and including statutory, common law, intentional tort and equitable claims) arising from or relating to this Agreement or application for this transaction or advertisements, promotions or oral or written statements relating to this Agreement or the relationships which result from this Agreement (including, to the full extent permitted by applicable law, relationships with third- parties who are not signatories to this Agreement or this Arbitration Provision), or the validity, enforceability or scope of this Arbitration Provision or the entire Agreement (collectively "Claim"), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision and the Commercial Arbitration Rules in effect at the time the Claim is filed. A party who has asserted a claim in a lawsuit in court may elect arbitration with respect to any claim(s) subsequently asserted in that lawsuit by any other party or parties. The Commercial Arbitration Rules may be obtained by calling the phone number or visiting the web site identified in Paragraph 1 above; provided, however, that if for any reason the AAA is unable or unwilling or ceases to serve as arbitration administrator, an equivalent national arbitration organization utilizing a similar code of procedure will be substituted by us. There shall be no authority for any claims to be arbitrated on a class action basis. Further, an arbitration can only decide our or your Claim and may not consolidate or join the claims of other persons who may have similar claims. Any participatory arbitration hearing that you attend will take place in the federal judicial district of your residence. At your written request, we will advance the first $50 of the filing and hearing fees for any Claim which you may file against us. The arbitrator will decide whether we or you will ultimately be responsible for paying any fees in connection with the arbitration. Unless inconsistent with applicable law, each party shall bear the expense of their respective attorney's, experts and witness fees, regardless of which party prevails in the arbitration. This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16. The arbitrator shall apply applicable substantive law consistent with the FAA and applicable statutes of limitations and shall honor claims of privilege recognized by law. Judgement upon the award rendered by the arbitrator may be entered in any court having jurisdiction. This Arbitration Provision shall survive satisfaction of your contractual obligations and termination of this Agreement. If any portion of this Arbitration Provision is deemed invalid or unenforceable under the FAA, it should not invalidate the remaining portions of this Arbitration Provision.

3. Customer's Representations. By signing the Agreement, you hereby represent and warrant, and acknowledge Licensee's reliance thereon, that all information provided in your credit application and contained in this Agreement is true and correct. You further represent and warrant that you are not a debtor under any proceeding in bankruptcy, insolvency, or reorganization and that you have no intention to file a petition for relief under any chapter of the United States Bankruptcy Code on or before the Payment Due Date.

4. Authorization to Verify Information. By signing this Agreement, you hereby authorize us and our agents to verify the information contained in your credit application or contained in this agreement through any source, including our accessing your bank account information to verify whether funds are available to pay your Check, our obtaining your credit report, and our obtaining your check-writing history from any consumer information database.

5. Dishonored Check Fee. If, for any reason, your bank dishonors your Check and it is returned to us unpaid, you agree to pay us a dishonored check fee in the amount of $ 30.00.

6. Department of Banking and Finance. Should you have any question regarding this agreement, you may contact the Office of Comptroller, Department of Banking and Finance, The Fletcher Building, Suite 636, 101 East Gaines Street, Tallahassee, Florida 32399-0350, Phone number (850) 410-9370.

REVIEWED AND AGREED.

Customer Initials _____

Date _____

TAMPA / CLEARWATER

- 1916 Gulf to Bay Boulevard., Clearwater,FL 33765
- 7644 Park Boulevard., Pinellas Park,FL 33781
- 319 North Dale Mabry Highway., Tampa,FL 33609

WEST PALM BEACH

- 2835 N Military Trail., West Palm Beach,FL 33409
- 795 Northlake Blvd., North Palm Beach.,FL 33408
- 4647/ 4649 Lake Worth Road., Lake Worth,FL 33463

Buckeye Check Cashing INC.
dba CHECKS$MART
Deferred Deposit and Disclosure Agreement

V

Today's Date 05/12/00

Borrower

Name DONNA, REUTER

Address 1832 S A STREET APT B

City LAKE WORTH State FL Zip 33460

Home Phone 4935029

Work Phone 7126535

Social Security Number 173582830

Weekly Net Income

Check$mart Licensed State of Florida

Deferred Deposits made are subject to State of Florida Authority

#176

(189)

Itemization of Amount Financed	Annual Percentage Rate	Finance Charge	Amount Financed	Total of Payments
1 Actual Cash You Receive. 300.00	The cost of your credit as a yearly rate	Deferred Deposit origination fee plus interest amount	This amount of credit provided to you or on your behalf	The amount you will have paid after you have made all payments
2 Total Finance Charge. 38.33	333.11 %	$ 38.33	$ 300.00	$ 338.33
3 Total Note Amount 338.33				

Security Unsecured

Payment Schedule One Payment in the amount of $ 338.33 Due on (Month) 5/26 (Day) 00

Promise to Pay: You promise to pay the Deferred Deposit (total of payments plus any other permitted charges) to the order of Check$mart according to the terms stated herein.

Refund for Payment: If, after the first month of the contract, the Deferred Deposit is repaid in full before the final installment payment date, any unearned interest for the unexpired period of the Deferred Deposit contract that follows the date of payment in full will be refunded according to the sum of the digits method sometimes called the "Rule of 78ths," according to applicable law.

Finance Charge: The Finance Charge consists of interest and fee only. If interest on this Deferred Deposit is not precomputed, the Finance Charge is computed on outstanding unpaid principal balances on the basis that installments shall have been paid according to the contract. Delinquency will increase the Finance Charge as the contract rate is computed on actual unpaid balances on the amount financed for the actual time outstanding.

Prepayment: You may repay this contract in full at any time. However you agree to pay a minimum finance charge of $ as allowed by Florida law, if you pay this contract off before Check$mart has earned that much in Finance Charges with in the first month.

Check Collection Charges: You will be charged for any check collection charges made by a financial institution for each check returned or dishonored for any reason upon the same terms and conditions upon which such check collection charges are made by the financial institution.

Other Terms: This contract cannot be assumed by third party without the written consent of Check$mart.

CHECKS WILL BE DEPOSITED ON THE DUE DATE ABOVE. TO GUARANTEE AVAILABILITY, CHECKS MUST BE PICKED UP PRIOR TO THIS DUE DATE.

BANKRUPTCY: I DO NOT INTEND TO INCLUDE THIS CHECK IN ANY BANKRUPTCY PROCEEDING. I AM NOT CURRENTLY FILING AND DO NOT ANTICIPATE FILING BANKRUPTCY.

THE FEE CHARGE FOR A DEFERRED DEPOSIT TRANSACTION IS A SERVICE FEE AND NOT INTEREST. THIS DISCLOSURE IS PROVIDED TO YOU PURSUANT TO THE FEDERAL TRUTH IN LENDING ACT, 15 U.S.C. 1601 ET SEQ. AND THE REGULATIONS PROMULGATED THEREUNDER, IN PARTICULAR REGULATION Z, 12 CFR PART 226. THE SERVICE FEES CHARGED FOR THE DEFERRED DEPOSIT TRANSACTION ARE INCLUDED IN THE CALCULATION OF AN ANNUAL PERCENTAGE RATE. THIS DOCUMENT IS FOR DISCLOSURE PURPOSES ONLY AND DOES NOT AFFECT THE CHARACTER OF THE FEES UNDER FLORIDA LAW.

I have signed this Deferred Deposit agreement on the date below and acknowledge that I have read it, understand it, and that I have received a complete copy of it.

Borrower's signature _____ Date 05/12/00

05/12/00

"WARNING: THE RATE OF INTEREST CHARGED ON THIS DEFERRED DEPOSIT AGREEMENT IS HIGHER THAN THE AVERAGE RATE OF INTEREST CHARGED BY FINANCIAL INSTITUTIONS ON SUBSTANTIALLY SIMILAR LOANS."

Customer Service Representative Please check the following

- ☐ Does the customer have a prior loan? Verify that the prior loan has been paid (check has cleared)
- ☐ Verify that the customer's home and work phone numbers are written above
- ☐ Update the Customer Information Screen on the Answers system, including your initials and today's date
- ☐ Verify that the check is written for the total amount of the loan
- ☐ Verify that the weekly income shown above is not less than the total amount of the loan
- ☐ Verify that the date the check is written for is the date that the check will be deposited
- ☐ Verify that deposit date is the customer's next payday or the following day

SEE REVERSE FOR STORE LOCATIONS

ADDITIONAL TERMS AND CONDITIONS

1. Arbitration Disclosure. By signing this Agreement, you agree that if a dispute of any kind arises out of this Agreement or your application therefore or [illegible] than either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below. If arbitration is chosen, it will be conducted with the American Arbitration Association (the "AAA") pursuant to the AAA's Commercial Arbitration Rules. If you have any questions concerning the AAA or if you wish to obtain a copy of the AAA's Commercial Arbitration Rules, you may call (800) 891-4741 or visit http --www.adr.org o.- the Wund Wide Web

2. Arbitration Provisions. Any claim, dispute, or controversy (whether in contract, tort or otherwise, whether pre-exis[illegible] [illegible] including statutory, common law, intentional tort, and equitable claims) arising from or relating to this Agreement or [illegible] or advertisements, promotions, or oral or written statements relating to this Agreement or the relationships which [illegible] (including, to the full extent permitted by applicable law, relationships with third- parties who are not signatories to this Agreement or this Arbitration Provision) or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement (collectively "Claim"), shall be resolved upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision and the Commercial Arbitration Rules in effect at the time the Claim is filed. A party who has asserted a claim in a lawsuit in court may elect arbitration with respect to any claim(s) subsequently asserted in that lawsuit by any other party or parties. The Commercial Arbitration Rules may be obtained by calling the phone number or visiting the web site identified in Paragraph 1 above; provided, however, that if for any reason the AAA is unable or unwilling or ceases to serve as arbitration administrator, an equivalent national arbitration organization utilizing a similar code of procedure will be substituted by us. There shall be no authority for any claims to be arbitrated on a class action basis. Further, an arbitration can only decide our or your Claim and may not consolidate or join the claims of other persons who may have similar claims. Any participatory arbitration hearing that you attend will take place in the federal judicial district of your residence. At your written request, we will advance the first $50 of the filing and hearing fees for any Claim which you may file against us. The arbitrator will decide whether we or you will ultimately be responsible for paying any fees in connection with the arbitration. Unless inconsistent with applicable law, each party shall bear the expense of their respective attorney's, experts, and witness fees, regardless of which party prevails in the arbitration. This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16. The arbitrator shall apply applicable substantive law consistent with the FAA and applicable statues of limitations and shall honor claims of privilege recognized by law. Judgement upon the award rendered by the arbitrator may be entered in any court having jurisdiction. This Arbitration Provision shall survive satisfaction of your contractual obligations and termination of this Agreement. If any portion of this Arbitration Provision is deemed invalid or unenforceable under the FAA, it should not invalidate the remaining portions of this Arbitration Provision.

3. Customer's Representations and Warranties. By signing the Agreement, you hereby represent and warrant, and acknowledge Licensee's reliance there on, that all information contained in your credit appecation and contained in this Agreement is true and correct. You further represent and warrant that you are not a debtor under any proceeding in bankruptcy, insolvency, or reorganization and that you have no intention to file a petition for relief under any chapter of the United States Bankruptcy Code on or before the Payment Due Date.

4. Authorization to Verify Information. By signing this Agreement, you hereby authorize us and our agents to verify the information contained in your credit application or contained in this agreement through any source, including our accessing your bank account information to verify whether funds are available to pay your Check, our obtaining your credit report, and our obtaining your check-writing history from any consumer information database.

5. Dishonored Check Fee. If, for any reason, your bank dishonors your Check and it is returned to us unpaid, you agree to pay us a dishonored check fee in the amount of $ 30.00.

6. Department of Banking and Finance. Should you have any question regarding this agreement, you may contact the Office of Comptroller, Department of Banking and Finance, The Fletcher Building, Suite 636, 101 East Gaines Street, Tallahassee, Florida 32399-0350, Phone number (850) 410-9370.

REVIEWED AND AGREED

Customer Initials _____

Date 05-12-00

TAMPA / CLEARWATER

- 1916 Gulf to Bay Boulevard., Clearwater,FL 33765
- 7644 Park Boulevard., Pinellas Park,FL 33781
- 319 North Dale Mabry Highway., Tampa,FL 33609

WEST PALM BEACH

- 2835 N Military Trail., West Palm Beach,FL 33409
- 795 Northlake Blvd., North Palm Beach.,FL 33408
- 4647/ 4649 Lake Worth Road., Lake Worth,FL 33463

Buckeye Check Cashing INC.
dba CHECKS$MART
Deferred Deposit and Disclosure Agreement

Today's Date _____ Borrower

Name _____

Address _____ Home Phone _____

City _____ State _____ Zip _____ Work Phone _____

Social Security Number _____ Weekly Net Income _____

CheckSmart Licensed State of Florida

Deferred Deposits made are subject to State of Florida Agency

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Itemization of Amount Financed	Annual Percentage Rate	Finance Charge	Amount Financed	Total of Payments
	The cost of your credit as a yearly rate	Deferred Deposit origination fee plus interest amount	The amount of credit provided to you or on your behalf	The amount you will have paid after you have made all payments
1 Actual Cash You Receive _____	_____ %	$ _____	$ _____	$ _____
2 Total Finance Charge _____				
3 Total Note Amount _____				

(Month) (Day)

Security Unsecured

Payment Schedule One Payment in the amount of $ _____ Due on _____

Promise to Pay: You promise to pay the Deferred Deposit (total of payments, plus any other permitted charges) to the order of Check$mart according to the terms stated herein.

Refund for Payment: If, after the first month of the contract, the Deferred Deposit is repaid in full before the final installment payment date, any unearned interest for the unexpired period of the Deferred Deposit contract that follows the date of payment in full will be refunded according to the sum of the digits method sometimes called the "Rule of 78ths," according to applicable law.

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Prepayment: You may repay this contract in full at any time. However you agree to pay a minimum finance charge of $ 49.44 as allowed by Florida law if you pay this contract off before Check$mart has earned that much in Finance Charges with in the first month.

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I have signed this Deferred Deposit agreement on the date below and acknowledge that I have read it, understand it, and that I have received a complete copy of it.

Borrower's signature _____ Date _____

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Customer Service Representive: Please check the following

- ☐ Does the customer have a prior loan? Verify that the prior loan has been paid (check has cleared)
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- ☐ Verify that the check is written for the total amount of the loan
- ☐ Verify that the weekly income shown above is not less than the total amount of the loan
- ☐ Verify that the date the check is written for is the date that the check will be deposited
- ☐ Verify that deposit date is the customer's next payday or the following day

SEE REVERSE FOR STORE LOCATIONS

ADDITIONAL TERMS AND CONDITIONS

1. Arbitration Disclosure. By signing this Agreement, you agree that if a dispute of any kind arises out of this Agreement or your application therefore or any instrument relating thereto, then either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below. If arbitration is chosen, it will be conducted with the American Arbitration Association (the "AAA") pursuant to the AAA's Commercial Arbitration Rules. If you have any questions concerning the AAA or if you wish to obtain a copy of the AAA's Commercial Arbitration Rules, you may call (800) 891-4741 or visit http://www.adr.org on the World Wide Web.

2. Arbitration Provisions. Any claim, dispute, or controversy (whether in contract, tort or otherwise, whether pre-existing, present, or future, and including statutory, common law, intentional tort, and equitable claims) arising from or relating to this Agreement or application for this transaction or advertisements, promotions, or oral or written statements relating to this Agreement or the relationships which result from this Agreement (including, to the full extent permitted by applicable law, relationships with third- parties who are not signatories to this Agreement or this Arbitration Provision) or the validity, enforceability or scope of this Arbitration Provision or the entire Agreement (collectively "Claim"), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision and the Commercial Arbitration Rules in effect at the time the Claim is filed. A party who has asserted a claim in a lawsuit in court may elect arbitration with respect to any claim(s) subsequently asserted in that lawsuit by any other party or parties. The Commercial Arbitration Rules may be obtained by calling the phone number or visiting the web site identified in Paragraph 1 above; provided, however, that if for any reason the AAA is unable or unwilling or ceases to serve as arbitration administrator, an equivalent national arbitration organization utilizing a similar code of procedure will be substituted by us. There shall be no authority for any claims to be arbitrated on a class action basis. Further, an arbitration can only decide our or your Claim and may not consolidate or join the claims of other persons who may have similar claims. Any participatory arbitration hearing that you attend will take place in the federal judicial district of your residence. At your written request, we will advance the first $50 of the filing and hearing fees for any Claim which you may file against us. The arbitrator will decide whether we or you will ultimately be responsible for paying any fees in connection with the arbitration. Unless inconsistent with applicable law, each party shall bear the expense of their respective attorney's, experts' and witness fees, regardless of which party prevails in the arbitration. This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16. The arbitrator shall apply applicable substantive law consistent with the FAA and applicable statutes of limitations and shall honor claims of privilege recognized by law. Judgement upon the award rendered by the arbitrator may be entered in any court having jurisdiction. This Arbitration Provision shall survive satisfaction of your contractual obligations and termination of this Agreement. If any portion of this Arbitration Provision is deemed invalid or unenforceable under the FAA, it should not invalidate the remaining portions of this Arbitration Provision.

3. Customer's Representations and Warranties. By signing the Agreement, you hereby represent and warrant, and acknowledge Licensee's reliance thereon, that all information contained in your credit application and contained in this Agreement is true and correct. You further represent and warrant that you are not a debtor under any proceeding in bankruptcy, insolvency, or reorganization and that you have no intention to file a petition for relief under any chapter of the United States Bankruptcy Code on or before the Payment Due Date.

4. Authorization to Verify Information. By signing the Agreement, you hereby authorize us and our agents to verify the information contained in your credit application or contained in this agreement through any source, including our accessing your bank account information to verify whether funds are available to pay your Check, our obtaining your credit report, and our obtaining your check-writing history from any consumer information database.

5. Dishonored Check Fee. If, for any reason, your bank dishonors your Check and it is returned to us unpaid, you agree to pay us a dishonored check fee in the amount of $ 30.00.

6. Department of Banking and Finance. Should you have any question regarding this agreement, you may contact the Office of Comptroller, Department of Banking and Finance, The Fletcher Building, Suite 636, 101 East Gaines Street, Tallahassee, Florida 32399-0350, Phone number (850) 410-9370.

REVIEWED AND AGREED

Customer Initials DLP

Date 09-02-00

TAMPA / CLEARWATER

- 1916 Gulf to Bay Boulevard., Clearwater,FL 33765
- 7644 Park Boulevard., Pinellas Park,FL 33781
- 319 North Dale Mabry Highway., Tampa,FL 33609

WEST PALM BEACH

- 2835 N Military Trail., West Palm Beach,FL 33409
- 795 Northlake Blvd., North Palm Beach.,FL 33408
- 4647/ 4649 Lake Worth Road., Lake Worth,FL 33463

Supreme Court, U.S.
FILED
AUG 12 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ of Certiorari to the Supreme Court of Florida

BRIEF FOR PETITIONER

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August 12, 2005

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

QUESTION PRESENTED

Whether the Florida Supreme Court erred by holding that the Federal Arbitration Act allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality.

PARTIES TO THE PROCEEDING

Petitioner Buckeye Check Cashing, Inc. was respondent in the Florida Supreme Court. Respondents John A. Cardegna and Donna Reuter were petitioners in that court.

Pursuant to Rule 29.6 of the Rules of this Court, petitioner hereby states that it has no parent corporation, and that no publicly traded company owns 10% or more of its stock.

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INTRODUCTION

Almost forty years ago, in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), this Court held that the Federal Arbitration Act ("FAA") does not allow a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) was fraudulently induced. Under the FAA, the *Prima Paint* Court explained, a challenge to the validity of the underlying contract is severable from a challenge to the validity of the arbitration clause. Thus, once it is clear that the parties have agreed to arbitrate their dispute, the arbitrator—not the court—must resolve any challenge to the validity of the underlying contract in the first instance.

That principle is controlling here, because respondents are challenging the validity of their underlying contracts with petitioner, but their challenge does not implicate the making of their agreement to arbitrate. Respondents neither deny that they assented to an arbitration agreement, nor challenge the arbitration agreement itself as illegal. Rather, respondents contend only that the underlying contracts are illegal as usurious. Under *Prima Paint*, that challenge must be resolved in the first instance by an arbitrator, not a court.

The Florida Supreme Court, however, attempted to distinguish *Prima Paint* on the ground that the challenge there (fraud in the inducement) would have rendered the underlying contract *voidable* under state law, whereas the challenge here (illegality) would render the underlying contracts *void* under state law. But, as Justice Cantero noted in dissent below, that is a distinction without a difference in this context. Whether the underlying contracts are alleged to be voidable or void as a matter of *state* law has nothing to do with the real issue—whether respondents' challenge to the legality of their underlying contracts implicates their assent to arbitration as a matter of *federal* law. Not surprisingly, thus, all six federal courts of appeals that have considered this issue have concluded

that a party cannot avoid arbitration under *Prima Paint* by simply challenging the underlying contract as illegal. *See Jenkins v. First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 880-82 (11th Cir. 2005); *Bess v. Check Express*, 294 F.3d 1298, 1304-06 (11th Cir. 2002); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 636-38 (4th Cir. 2002); *Burden v. Check Into Cash of Ky., LLC*, 267 F.3d 483, 489-90 (6th Cir. 2001); *Harter v. Iowa Grain Co.*, 220 F.3d 544, 550 (7th Cir. 2000); *3H & Assocs., Inc. v. Hanjin Eng'g & Constr. Co.*, No. 97-16751, 1998 WL 657722, at *2 (9th Cir. Sept. 3, 1998) (unpublished); *Lawrence v. Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1161-62 (5th Cir. 1987). As these courts recognize, *Prima Paint* establishes as a matter of *federal* law that the alleged invalidity of an underlying contract does not "taint" or otherwise prevent enforcement of an arbitration clause to which the parties concededly have assented.

Because the Florida Supreme Court majority (as the dissent below noted) "disregard[ed] controlling federal law and the federal preference for enforcing arbitration clauses," Pet. App. 26a, this case once again calls for this Court to vindicate federal arbitration rights against the very hostility that motivated the FAA in the first place. Accordingly, this Court should reverse the judgment.

OPINIONS BELOW

The Florida Supreme Court's decision is reported at 894 So. 2d 860 (2005), and reprinted in the Appendix to the Petition for Certiorari ("Pet. App.") at 1a-26a. The Florida District Court of Appeal's decision is reported at 824 So. 2d 228 (2002), and reprinted at Pet. App. 27a-32a. The Florida trial court's unreported decision denying petitioner's motion to compel arbitration is reprinted at Pet. App. 33a-34a.

JURISDICTION

The Florida Supreme Court rendered its decision on January 20, 2005. Pet. App. 1a. Petitioner filed a timely petition for certiorari on March 21, 2005. This Court granted that petition on June 20, 2005. The Court has jurisdiction pursuant to 28 U.S.C. § 1257(a).

PERTINENT STATUTORY PROVISIONS

Section 2 of the Federal Arbitration Act provides in pertinent part:

> A written provision in … a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

Section 4 of the Federal Arbitration Act provides in pertinent part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action … of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. … The court shall hear the parties, and upon being satisfied that the making of the agreement for

> arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. ... If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

9 U.S.C. § 4.

STATEMENT OF THE CASE

A. Factual Background

Petitioner Buckeye Check Cashing, Inc. provides check-cashing and payday advance (or "deferred presentment") services in many States, including Florida. These services allow consumers to obtain immediate cash, either by cashing a third-party check or (more commonly) by writing a personal check to be cashed at some future date against anticipated income. Payday advances are typically short-term, small-dollar transactions that, for a service fee, allow consumers to deal with unanticipated cash-flow shortfalls between regularly scheduled paydays. Buckeye is licensed to do business in Florida under that State's Check Cashing and Foreign Currency Exchange Act, Fla. Stat. § 560.301, and its conduct is comprehensively regulated under the State's Deferred Presentment Act, Fla. Stat. § 560.401 *et seq*.

Respondents John A. Cardegna and Donna Reuter (collectively "plaintiffs") entered into separate deferred presentment transactions with Buckeye throughout 1999 and 2000. With each transaction, plaintiffs signed a "Deferred Deposit and Disclosure Agreement," which (among other things) documented the amount of each cash advance, detailed the service fees associated with each such advance (both as a dollar amount and as an annual percentage rate equivalent), and denoted the date on which Buckeye would seek to redeem the

personal checks plaintiffs presented at the time of their respective transactions.[1] Each of those contracts specified that "[t]he fee charge[d] for a deferred deposit transaction is a service fee and not interest." JA 35, 37, 39, 41.

Each contract also contained a broad arbitration provision, which plaintiffs were required to review and separately initial every time they conducted a transaction with Buckeye. In relevant part, those provisions state:

> 1. Arbitration Disclosure. By signing this Agreement, you agree that i[f] a dispute of any kind arises out of this Agreement or your application therefore or any instrument relating thereto, th[e]n either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below.
>
> 2. Arbitration Provisions. Any claim, dispute, or controversy (whether in contract, tort or otherwise, whether pre-existing, present, or future, and including statutory, common law, intentional tort, and equitable claims) arising from or relating to this Agreement ... *or the validity, enforceability, or scope of* this Arbitration Provision or *the entire Agreement* (collectively "Claim"), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration pursuant to this Arbitration Provision.... This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be

[1] All told, respondent Cardegna entered into 34 transactions with Buckeye, and respondent Reuter entered into 9 such transactions, and each respondent executed a separate contract for each transaction. The wording of the relevant provisions of each contract is identical. Representative contracts were included in the record below, and are set forth in the Joint Appendix ("JA") at 35-42.

> governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. Sections 1-16. The arbitrator shall apply applicable substantive law cons[istent] with the FAA and applicable statu[t]es of limitations and shall honor claims of privilege recognized by law.

JA 36, 38, 40, 42 (emphasis added).

B. Proceedings Below

In February 2001, plaintiffs filed a putative class action against Buckeye in the Fifteenth Judicial Circuit of Florida. JA 12-34.[2] The complaint alleged that the fees Buckeye charged for its check cashing services were actually usurious interest rates on loans. Thus, according to plaintiffs, Buckeye was engaged in unlawful "shylocking," JA 26, and the transactions violated provisions of Florida's Lending Practices Statutes, the Florida Consumer Finance Act, the Florida Deceptive and Unfair Trade Practices Acts, and the Florida Civil Remedies for Criminal Practices Act, JA 25-32. As relief, plaintiffs sought, *inter alia*, (1) "injunctive relief against the Defendants prohibiting them from continuing to engage in the illegal conduct as alleged," (2) that "[t]he Defendants be ordered to cease their efforts to collect monies from Plaintiffs and class members," (3) that "the transactions between Plaintiffs and members of the class and Defendants be declared void and Plaintiffs and members of the class be awarded all sums paid to Defendants including but not limited to principal, double interest, and any other fees, including collection costs paid, for each and every transaction," (4) "actual damages, attorneys' fees and costs," (5) "treble damages supplemental to damages awarded under any other claim, costs and attorneys' fees," and (6) "expenses, costs, pre-judgment and post-judgment interest." JA 32-33.

---

[2] The complaint also named as a defendant, in addition to petitioner Buckeye Check Cashing, Inc., another entity named "Buckeye Check Cashing of Florida, Inc." Plaintiffs, however, never served the complaint on that entity.

Buckeye timely removed the case to federal court based on diversity of citizenship, and moved to compel arbitration and stay all proceedings. JA 6. The district court (Hurley, J.), however, remanded the case, holding that Buckeye had failed to establish that the amount in controversy exceeded the jurisdictional threshold. JA 7.

Back in state court, Buckeye again moved to compel arbitration of plaintiffs' claims and stay all proceedings. JA 2-3. After briefing and argument, the trial court (Barkdull, J.) summarily denied Buckeye's motion. Pet. App. 33a-34a. The court did not deny that plaintiffs' claims fell within the broad language of the parties' arbitration agreement, but relied on two Florida intermediate appellate decisions from another district holding that a court, not an arbitrator, must resolve a challenge to the legality of the underlying contract. Pet. App. 34a (citing *Party Yards, Inc. v. Templeton*, 751 So. 2d 121 (Fla. Dist. Ct. App. 2000); *FastFunding v. Betts*, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000)).

Buckeye immediately appealed that order, and the intermediate appellate court reversed. *See* Pet. App. 27a-32a. The court noted that while plaintiffs alleged that "the underlying contract is void ab initio because it is criminally usurious and, therefore, never existed at all," Pet. App. 30a, they "did not argue that they did not enter into the arbitration agreement, nor did they challenge the validity of the terms of the arbitration agreement." Pet. App. 32a. Relying on the Eleventh Circuit's decision in *Bess* (which in turn relied on this Court's decision in *Prima Paint*), the court therefore held that the parties' arbitration agreement was enforceable and that plaintiffs' challenge to the validity of the underlying contracts must be resolved by an arbitrator, not a court, in the first instance. *See* Pet. App. 31a-32a.

Plaintiffs appealed that decision to the Florida Supreme Court, which—in a divided decision—again reversed.

Pet. App. 1a-26a. The majority held that "an arbitration provision contained in a contract which is void under Florida law cannot be separately enforced while there is a claim pending in a Florida trial court that the contract containing the arbitration provision is itself illegal and void ab initio." Pet. App. 1a. *Prima Paint* was not controlling, the majority held, because the challenge to the underlying contract there (fraud in the inducement) would have rendered the contract *voidable* under state law, whereas the challenge to the underlying contract here (illegality) would have rendered the contract *void* under state law. Pet. App. 5a-6a. The majority acknowledged that this holding was inconsistent with the Eleventh Circuit's analysis in *Bess*, but asserted that "the case presently before us is distinguishable because *Bess* was expressly resolved under federal law, not state law principles." Pet. App. 7a.

Justice Bell specially concurred to acknowledge "that the issue before us is one of federal law." Pet. App. 9a. Justice Bell proceeded, however, to "disagree with the conclusions that have been reached" by every federal appellate court to consider the issue. *Id.* While conceding that plaintiffs "do[] not dispute that [they] assented to the arbitration agreement," Justice Bell asserted that "assent alone does not make for a valid and enforceable contract." Pet. App. 12a. According to Justice Bell, "[t]he issue of the underlying contract's legality must be determined by the courts before any claim or dispute arising out of the contract may be referred to arbitration pursuant to the contract's arbitration clause." Pet. App. 12a.

Justice Cantero dissented, noting that "[t]he issue in this case is not whether a check-cashing contract is void as usurious," but "*who decides* whether the contract is void– -the arbitrator, as provided in the contract itself, or the court." Pet. App. 13a (emphasis in original). That issue, Justice Cantero explained, is one of *federal* law under *Prima Paint*. Pet. App. 14a. Justice

Cantero further noted that the void/voidable distinction on which the majority relied "is arbitrary and totally disconnected" from the language of the FAA. Pet. App. 17a. Indeed, he pointed out, "[i]n the last three years no fewer than three federal courts of appeals have decided the precise issue we confront today—whether, under the FAA, the issue of whether a check-cashing transaction is void as usurious is for the court or the arbitrator to decide," and "*[e]very one* unanimously has held that the issue is one for the arbitrators." *Id.* (referring to *Bess*, 294 F.3d at 1304-06; *Snowden*, 290 F.3d at 636-38; and *Burden*, 267 F.3d at 489-90) (emphasis in original). Justice Cantero concluded that "[w]e should follow *Bess*, *Snowden*, and *Burden*, which considered the identical issue under identical facts and held that, under the plain language of the FAA, the issue of whether a check-cashing transaction is usurious must be determined by the arbitrators." Pet. App. 20a.

SUMMARY OF ARGUMENT

Three straightforward points dispose of this case: (1) plaintiffs do not deny that their dispute with Buckeye falls within the broad scope of the parties' arbitration agreements, which expressly encompass challenges to "the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement," JA 35, 37, 39, 41; (2) plaintiffs do not deny that they assented to those arbitration agreements; and (3) plaintiffs do not challenge those arbitration agreements themselves (as opposed to the underlying contracts) as illegal or otherwise unenforceable. In light of these three undisputed points, the Florida Supreme Court erred by holding that the trial court was neither required nor permitted to enforce the parties' arbitration agreement.

The Florida Supreme Court based that holding on the proposition that a party can avoid arbitration by challenging the legality of the underlying contract on grounds totally unrelated to arbitration (here, alleged usury). That proposition, however,

is squarely inconsistent with federal law. As this Court explained in *Prima Paint*, the FAA establishes that a challenge to the validity of an underlying contract is severable from a challenge to the validity of an arbitration clause. The Florida court purported to distinguish *Prima Paint* on the theory that the challenge to the underlying contract there (fraud in the inducement) would have rendered the contract *voidable* under state law, whereas the challenge to the underlying contract here (illegality) would render the contract *void* under state law. Under *Prima Paint*, however, the severability issue is not governed by state law at all, but rather by federal law under the FAA. Thus, unless a party challenges its assent to arbitration, any challenge to the validity of the underlying contract (as opposed to the arbitration clause itself) must be presented in the first instance to the arbitrator. Because plaintiffs' challenge to the underlying contracts here (illegality in light of alleged usury) does not implicate their assent to arbitration, that challenge must be resolved in the first instance by an arbitrator, not a court.

ARGUMENT

The Florida Supreme Court Erred By Allowing Plaintiffs To Avoid Arbitration By Claiming That The Underlying Contract Containing An Arbitration Clause (But Not The Arbitration Clause Itself) Is Void For Illegality.

The Florida Supreme Court erred by holding that the FAA allows plaintiffs to avoid arbitration by claiming that their underlying contracts with Buckeye (but not the arbitration clauses of those contracts) are void for illegality. That holding contravenes this Court's seminal decision in *Prima Paint*, which established—as a matter of the "*federal* substantive law of arbitrability," *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (emphasis added) (discussing *Prima Paint*)—that a challenge to the validity of an underlying contract is severable from a challenge to the validity

of an arbitration clause. *See* 388 U.S. at 402-04. That principle controls this case, and requires enforcement of the parties' arbitration agreements. Plaintiffs are free to pursue their claims of illegality before the arbitrator, but cannot use those claims to avoid arbitration altogether.

The Florida Supreme Court, however, asserted that "the rationale of *Prima Paint* should not be extended to the facts of this case." Pet. App. 5a. According to that court, "[t]here is a key distinction between the claim in *Prima Paint* and the claim presently before us: in *Prima Paint*, the claim of fraud in the inducement, if true, would have rendered the underlying contract merely *voidable*," whereas the claim of illegality here, if true, would render the contract "*void* from the outset" under state law. Pet. App. 5a-6a (emphasis modified). Thus, the court asserted, "if the underlying contract is held entirely void as a matter of law, all of its provisions, including the arbitration clause, would be nullified as well." Pet. App. 6a; *see also id.* at 7a ("We conclude that Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract.").

The void/voidable distinction on which the Florida Supreme Court relied has no basis in the FAA. Rather, it is a *state* law distinction regarding the appropriate remedy for wrongdoing in the formation of a contract: certain wrongdoing renders the contract voidable at the election of the wronged party, whereas other wrongdoing renders the contract void ab initio. *See, e.g.*, 17A C.J.S. *Contracts* § 137 (1999). As a practical matter, that distinction means that the wronged party has the option of enforcing the contract under certain circumstances (where the contract is voidable), but that neither party has the option of enforcing the contract under other circumstances (where the contract is void ab initio). *See id.; see also Pitts v. Pastore*, 561 So. 2d 297, 300 (Fla. Dist. Ct. App. 1990).

Whether a contract is void or voidable as a matter of *state* law, however, has nothing to do with the *federal* severability analysis adopted in *Prima Paint*. Indeed, this Court granted certiorari in *Prima Paint* precisely to decide whether severability under the FAA is governed by state or federal law, an issue that previously had divided the lower courts. In particular, the Second Circuit had held that "arbitration clauses as a matter of *federal* law are 'separable' from the contracts in which they are embedded, and that where no claim is made that fraud was directed at the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud." 388 U.S. at 402 & n.8 (emphasis added; citing, *inter alia*, *In re Kinoshita & Co.*, 287 F.2d 951 (2d Cir. 1961); *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. granted*, 362 U.S. 909, *cert. dismissed*, 364 U.S. 801 (1960)). The First Circuit, in contrast, had held that "the question of 'severability' is one of *state* law, and that where a State regards such a clause as inseparable a claim of fraud in the inducement must be decided by the court." *Id.* at 403 & n.9 (emphasis added; citing *Lummus Co. v. Commonwealth Oil Ref. Co.*, 280 F.2d 915, 923-24 (1st Cir. 1960)).

The *Prima Paint* Court squarely endorsed the Second Circuit's approach. As the Court explained, "Congress has provided an explicit answer" to the question in the FAA, *id.* at 403, which directs courts to compel arbitration where "the making of the agreement for arbitration ... is not in issue," 9 U.S.C. § 4. Where a party to such an agreement challenges the validity of the underlying contract (as opposed to the validity of the arbitration clause itself), the Court held, "the making of the agreement for arbitration ... is not in issue" as a matter of *federal* law. *See* 388 U.S. at 404 ("[T]he statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally."). In other words, the FAA creates a federal rule of severability that distinguishes

between a challenge to the underlying contract and a challenge to the arbitration clause itself. Under the FAA, a court "may consider *only*" the latter challenge, *even if state law provides that the remedy for the former challenge is to nullify the entire contract, including the arbitration provision. See id.* (emphasis added). Justice Black dissented on precisely this point, noting that "[t]he Court here holds that the [FAA], *as a matter of federal substantive law*, compels a party to a contract containing a written arbitration provision to carry out his 'arbitration agreement' even though a court might ... hold the entire contract—including the arbitration agreement—*void* because of fraud in the inducement." *See id.* at 407 (dissenting opinion; emphasis added).

The lesson of *Prima Paint*, thus, is that a party cannot avoid an agreement to arbitrate unless that party challenges the making of that agreement. It follows that a court's role under the FAA is sharply limited: once it is clear that a party has assented to arbitration, any challenge to the validity of the underlying contract (as opposed to the arbitration agreement itself) must be presented in the first instance to the arbitrator. As Justice Cantero pointed out in dissent below, the relevant distinction under the FAA is between those challenges that implicate the making of an arbitration agreement and those that do not, rather than between those challenges that would render a contract void (as opposed to voidable) under state law. *See* Pet. App. 16a-17a (noting that void/voidable distinction "is arbitrary and totally disconnected from the statutory language," and that *Prima Paint* instead "distinguished between issues concerning the making of the underlying contract, which are arbitrable, and issues concerning the making of the arbitration agreement, which are not"); *see also id.* at 23a (same). It may be that some challenges that

implicate a party's assent to arbitration *also* would render a contract void under state law, but that is beside the point.[3]

The Florida Supreme Court thus erred by relying on a line of federal appellate cases that, it declared, "likewise distinguished *Prima Paint* and declined to extend its holding to instances where a party claims that a contract was void from its inception." Pet. App. 6a-7a (citing *Spahr v. Secco*, 330 F.3d 1266, 1272 (10th Cir. 2003); *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001); *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 110 n.9 (3d Cir. 2000); *Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851, 855 (11th Cir. 1992); *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1139-42 (9th Cir. 1991)). Each of those cases involved a claim that the plaintiff had never assented to the underlying contract in the first place, either because of a signatory's lack of authority (*Sphere Drake*, *Sandvik*, *Chastain*, *Three Valleys*), or mental incapacity (*Spahr*). Such claims, these courts held, *do* implicate "the making of the agreement for arbitration" within the meaning of *Prima Paint*, on the theory that if a signatory did not assent to the underlying contract, then the signatory necessarily did not assent to arbitration. Assuming that all of these cases were correctly decided, *but see Primerica Life Ins. Co. v. Brown*, 304 F.3d 469, 472 (5th Cir. 2002) (holding, in direct conflict with *Spahr*, that arbitrator is to decide a mental capacity defense that does not relate specifically to the arbitration agreement), the fact remains that none of these cases involved a challenge to the underlying

[3] Indeed, this case underscores Justice Cantero's point about the arbitrariness of the void/voidable distinction in this context. Although plaintiffs allege that their contracts with Buckeye are void ab initio, their complaint also requests that "[t]he Defendants be ordered to cease their efforts to collect monies from Plaintiffs and class members," JA 33, thereby effectively treating the contracts as voidable rather than void. Given that plaintiffs seek to retain the benefits of their contracts with Buckeye, they cannot really be arguing that those contracts never existed.

contract based on illegality—which, of course, goes to the *content* of the contract, not the parties' *assent*.

To the contrary, all six federal courts of appeals to address the latter issue (the Fourth, Fifth, Sixth, Seventh, Ninth, and Eleventh Circuits) have held that a party cannot avoid arbitration by simply challenging the underlying contract as illegal. *See, e.g.*, *Jenkins*, 400 F.3d at 880-82; *Bess*, 294 F.3d at 1304-06; *Snowden*, 290 F.3d at 636-38; *Burden*, 267 F.3d at 489-90; *Harter*, 220 F.3d at 550; *3H & Assocs.*, 1998 WL 657722, at *2; *Lawrence*, 833 F.2d at 1161-62. Such a challenge, these courts have recognized, does not implicate the "making of the agreement to arbitrate" because it does not implicate "questions of assent." *Bess*, 294 F.3d at 1305; *see also Jenkins*, 400 F.3d at 882 ("[The plaintiff] argues that the payday loan contracts are void, not because she failed to assent to the terms of the contracts, but because those terms render the contracts usurious and void under Georgia law."); *Snowden*, 290 F.3d at 637 ("[The plaintiff's] allegations of usurious rates of interest and non-licensure do not relate specifically to the Arbitration Agreement [nor do] they underlie a claim that [the plaintiff] failed to assent to the terms of the ... Agreement."); *Burden*, 267 F.3d at 490 (challenges based on alleged illegality of underlying contracts "do not concern [a] failure to assent"); *see also Metro East Center for Conditioning & Health v. Qwest Communications Int'l, Inc.*, 294 F.3d 924, 929 (7th Cir. 2002) ("Many decisions, of which *Prima Paint* ... is the leading example, hold that defenses to performance—even those that logically defeat arbitration—belong to the arbitrator as long as there is no doubt that the parties agreed to arbitrate."); *Alabama Catalog Sales v. Harris*, 794 So. 2d 312, 320 (Ala. 2000) (Lyons, J., dissenting) ("[The plaintiff's] contention that the contract is invalid is not grounded on a claim of want of assent, but rather on a claim of unenforceability notwithstanding assent."). Once it is clear that the parties agreed to arbitrate their dispute, any challenge to the legality of the underlying

contract must be resolved by the arbitrator, not the court, in the first instance.

Put another way, the general rule laid down by *Prima Paint* is that challenges directed at the underlying contract go to the arbitrator, while challenges directed at the arbitration clause go to the court. That general rule is subject to two qualifications, neither of which applies here. *First*, a challenge directed at the underlying contract goes to the court if it implicates the parties' assent, because a party that did not assent to the underlying contract by definition did not assent to an embedded arbitration clause. *See, e.g.*, *Sphere Drake*, 256 F.3d at 590-91. *Second*, and conversely, a challenge directed at the arbitration clause goes to the arbitrator if the parties "clearly and unmistakably" agreed to submit such disputes to arbitration. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942-47 (1995). The existence of these two qualifications, however, in no way negates the validity or force of the general rule.

That rule also makes sense, and comports with "the statutory policy of rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone*, 460 U.S. at 23. As this Court has stated time and again, "[a]rbitration under the FAA is a matter of consent." *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002) (brackets omitted; quoting *Volt Info. Scis., Inc. v. Board of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)); *see also First Options*, 514 U.S. at 943; *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995); *AT&T Techs., Inc. v. Communications Workers*, 475 U.S. 643, 649 (1986); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). Where, as here, the parties have agreed to arbitrate a particular dispute and do not challenge either that agreement itself or their assent to the underlying contract, the FAA requires a court to enforce the arbitration agreement forthwith. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 10-11 (1984) ("In enacting § 2 of the

[FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties *agreed* to resolve by arbitration.") (emphasis added). Because the validity of the agreement to arbitrate is distinct as a matter of federal law from the validity of the underlying contract between the parties, *see Prima Paint*, 388 U.S. at 402-04, a party cannot vitiate its assent to arbitration by simply challenging the validity of the underlying contract.

For this reason, the Florida Supreme Court's assertion that "Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract," Pet. App. 7a, misses the mark. Because the FAA renders an arbitration agreement legally severable from the underlying contract in which it is embedded, a court is not "breathing life" into the underlying contract by enforcing the arbitration agreement. Whether the underlying contract is good, bad, or indifferent is of no legitimate concern to the court. If the parties agreed to arbitrate their dispute, and do not challenge either the arbitration agreement itself or their assent to the underlying contract, that is the end of the matter as far as the court is concerned. *See Prima Paint*, 388 U.S. at 404. By enforcing the agreement to arbitrate, in other words, a court in no way places its imprimatur on the underlying contract (as opposed to the arbitration agreement); it simply is deciding that a dispute over that contract must be resolved in a different forum.

Indeed, as Justice Cantero pointed out in dissent below, the Florida Supreme Court's contrary approach reflects the very hostility to arbitration that the FAA was adopted to counteract. *See* Pet. App. 26a ("[T]he majority opinion evince[s] a basic distrust of arbitration [by] plac[ing] the court as jealous guardian of the determination of legal issues."). Arbitrators, no less than courts, are perfectly capable of following the law and

determining whether an underlying contract is illegal. *See, e.g., Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 231-32 (1987). Thus, just as federal courts must presume that state courts "know and follow the law," *Bell v. Cone*, 125 S. Ct. 847, 853 (2005) (*per curiam*) (internal quotation omitted), *both* federal and state courts must presume that arbitrators also know and apply the law. Indeed, the "liberal federal policy favoring arbitration agreements," *Moses H. Cone*, 460 U.S. at 24-25, requires (and presumes) no less. If the arbitrators were to exceed their authority, or otherwise manifestly disregard the law, then a court could always vacate their decision. *See* 9 U.S.C. § 10; *First Options*, 514 U.S. at 942; *cf. National R.R. Passenger Corp. v. Consolidated Rail Corp.*, 892 F.2d 1066, 1071 (D.C. Cir. 1990) ("If the arbitrator construes the contract so as to require someone to commit an illegal act, a court can then refuse to enforce the arbitrator's decision."). But speculation about that possibility provides no basis for refusing to enforce the arbitration agreement in the first place. *See, e.g., Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 89-92 (2000); *Booker v. Robert Half Int'l, Inc.*, 413 F.3d 77, 80-83 (D.C. Cir. 2005) (Roberts, J.).

It is no answer to say, as did the special concurrence below, that enforcing an arbitration agreement when the underlying contract is potentially illegal under state law "treat[s] arbitration clauses as a class of 'super' clauses, immune from a state's otherwise generally applicable contract law." Pet. App. 11a (Bell, J., specially concurring). As Justice Cantero explained, the FAA "treat[s] arbitration clauses not as a class of 'super' clauses, but as a class of *separate* clauses—separate, that is, from the other clauses in a contract." Pet. App. 20a (dissenting opinion; emphasis in original). Thus, arbitration clauses are not treated *differently* than other clauses, but "simply evaluated *independently* of the rest of the contract under the state's otherwise generally applicable contract law." *Id.* (emphasis in original; internal quotation omitted). To the extent that parties

challenge an arbitration agreement itself, or their assent to the underlying contract, and the parties have not clearly and unmistakably vested authority over such a challenge in the arbitrator, *see, e.g., First Options*, 514 U.S. at 943-45, a court will resolve that challenge under ordinary state contract law. Unless parties challenge the arbitration agreement itself or their assent to the underlying contract, however, any other challenge to the underlying contract must be referred to arbitration, where it also will be resolved under ordinary principles of state contract law.

Thus, the *only* principle of state contract law that is overridden by federal law under this approach is state severability law, to the extent it would treat a challenge to an arbitration agreement as inseverable from a challenge to the underlying contract. But the precise holding of *Prima Paint* is that the FAA governs this severability inquiry as a matter of federal substantive law. *See* 388 U.S. at 402-04 (endorsing the Second Circuit's approach that severability is a matter of federal law under the FAA, and rejecting the First Circuit's contrary approach). The Florida Supreme Court squarely contravened that holding by asserting that "there are no severable, or salvageable, parts of a contract found illegal and void under Florida law." Pet. App. 8a. *Prima Paint* has stood the test of time for almost four decades, during which time innumerable arbitration agreements have been executed, and there is no reason for this Court to revisit its holding now.

Indeed, as Justice Bell conceded (with some understatement) below, the Florida Supreme Court's contrary approach creates "a somewhat troubling 'circularity'": "we do not yet know if the check-cashing transactions are illegal under Florida law, so we do not know if the contract here really was void ab initio." Pet. App. 12a n.1 (specially concurring opinion). Justice Bell attempted to blunt the force of that concession by asserting that the alternative approach was equally circular: "if the arbitrator

were to conclude that the contracts were illegal and unenforceable, we then would have enforced an unenforceable contract." *Id.* That assertion, as explained above, is inaccurate: *Prima Paint* breaks the circle by severing the validity of the arbitration agreement from the validity of the underlying contract. Thus, even if the arbitrator were to find the underlying contract invalid, that invalidity would in no way "taint" the validity of the arbitration clause, or retroactively (and self-defeatingly) nullify the arbitrator's authority.

As a practical matter, moreover, the implications of the Florida Supreme Court's contrary approach are breathtaking. If a court were to decide the legality of the underlying contract in the course of deciding whether the dispute was arbitrable, there would be nothing left for the arbitrator to decide on the merits: the court effectively would have usurped the arbitrator's role. Thus, parties always could avoid arbitration by simply challenging some provision of the underlying contract as illegal. In this highly regulated day and age, virtually *all* contracts—from construction contracts to franchise agreements—can be (and have been) challenged as illegal and hence potentially void ab initio under state law. *See, e.g., John B. Goodman Ltd. P'ship v. THF Constr., Inc.*, 321 F.3d 1094, 1096-97 (11th Cir. 2003); *Nature's 10 Jewelers v. Gunderson*, 648 N.W.2d 804, 805 (S.D. 2002). The Florida Supreme Court's approach would thus effectively emasculate arbitration agreements by allowing plaintiffs to avoid such agreements at will by challenging the underlying contract as illegal on any ground.

Indeed, a Florida intermediate appellate court recently relied on the decision below in refusing to enforce an arbitration clause where the underlying contract was alleged to violate "public policy." *See Vacation Beach, Inc. v. Charles Boyd Constr., Inc.*, No. 5D04-4073, __ So. 2d __, 2005 WL 1704415, at *3 (Fla. Dist. Ct. App. July 22, 2005) ("[We] hold … that the

threshold challenge to the contract containing an arbitration provision based on the contract's illegality *or violation of public policy* must first be resolved by the trial court.") (emphasis added). That approach follows from the Florida Supreme Court's decision in this case, the court declared, because "[c]ontracts transgressing public policy … are considered to be illegal and will not generally be enforced by the courts." *Id.*; *see also Local No. 234 of United Ass'n of Journeymen & Apprentices of Plumbing v. Henley & Beckwith, Inc.*, 66 So. 2d 818, 823 (Fla. 1953) ("Agreements in violation of public policy are void because they have no legal sanction and establish no legitimate bond between the parties."). Needless to say, that approach would render arbitration a dead letter, since virtually any allegation of wrongdoing can be said to implicate a violation of "public policy." Thus, the opinion below effectively gives courts a license to ignore arbitration agreements at will.

In the final analysis, the Florida Supreme Court's approach turns the FAA upside down by *nullifying*, rather than *enforcing*, arbitration agreements. In unequivocal terms, the parties here agreed to arbitrate "any claim, dispute, or controversy … arising from or relating to … *the validity, enforceability, or scope of … the entire Agreement*." JA 36, 38, 40, 42 (emphasis added). By refusing to enforce arbitration of such a dispute, on the ground that the parties' underlying contracts might violate state usury laws, the Florida Supreme Court violated "[t]he liberal federal policy favoring arbitration agreements manifested by … the [FAA]." *Mitsubishi Motors*, 473 U.S. at 625 (internal quotation omitted). That policy, after all, "is at bottom a policy guaranteeing the enforcement of private contractual arrangements," and "as with any other contract, the parties' intentions control." *Id.* at 625-26. Needless to say, a court does not "rigorously enforce agreements to arbitrate," *id.* at 626 (internal quotation omitted), by expressly overriding the plain terms of the parties' arbitration agreement.

At bottom, this is a straightforward case. Plaintiffs do not deny that their dispute with Buckeye falls within the plain scope of their arbitration agreements. Nor do plaintiffs deny that they assented to those agreements. *See, e.g.*, Pet. App. 12a ("Cardegna does not dispute that he assented to the arbitration agreement.") (Bell, J., specially concurring); Pet. App. 32a ("Here, appellees did not argue that they did not enter into the arbitration agreement."). Nor do plaintiffs challenge any provision of the arbitration agreements themselves (as opposed to the underlying contracts) as illegal or otherwise unenforceable. *See, e.g.*, Pet. App. 10a ("It is also important to note that Cardegna does not claim that the arbitration clause itself (separately, as opposed to the contract as a whole) somehow is invalid.") (Bell, J., specially concurring); Pet. App. 28a ("[A]t the hearing before the trial court, [plaintiffs] did not argue that the arbitration provision was unconscionable. Accordingly, the issue of unconscionability is not properly before this court for review."). Under the FAA, these three points are dispositive, and a court must enforce the parties' arbitration agreements.

CONCLUSION

For the foregoing reasons, the judgment of the Florida Supreme Court should be reversed.

Respectfully submitted,

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August 12, 2005

FILED
9/23/05

(12)

No. 04-1264

IN THE
SUPREME COURT OF THE UNITED STATES

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ of Certiorari to the
Supreme Court of Florida

BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF RESPONDENTS

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BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF RESPONDENTS

INTEREST OF *AMICUS CURIAE*[1]

AARP is a non-partisan, non-profit organization with more than 35 million members dedicated to addressing the needs and interests of people 50 and older. As the largest membership organization serving this population, AARP is greatly concerned about unfair and deceptive financial products and services targeted at vulnerable consumers, including those involving a range of credit transactions. Because older Americans are disproportionately victimized by many of these practices, AARP advocates for the enactment and enforcement

[1] Letters indicating the parties' blanket consent to the filing of *amicus* briefs have been filed with the Clerk of the Court. No counsel for any party authored this brief in whole or in part, and no person or entity other than *amicus curiae*, its counsel, or its members made a monetary contribution to the preparation or submission of this brief.

of federal and state laws and regulations that protect consumers from exploitation in the credit marketplace.

AARP also supports laws and public policies designed to preserve the legal means for consumers to seek redress when they are harmed by fraudulent, deceptive, or unfair practices. To help achieve this, AARP advocates for improved access to the civil justice system and supports the availability of the full range of enforcement tools. AARP thus is concerned that access to the justice system for consumers has been severely curtailed by the growing number and range of corporations that impose binding arbitration as a condition of doing business. AARP has filed *amicus curiae* briefs in this Court and in federal and state courts around the country addressing the importance of preserving court access for consumers and ensuring that they can seek the full range of redress that Congress and state legislatures enacted for their benefit.

These issues are of particular concern for low-income consumers, those whom mainstream lenders consider "high risk" borrowers, and consumers on fixed incomes who often have difficulty finding credit on reasonable terms. They typically are relegated to high-cost lenders and non-traditional sources of credit where they often are subjected to deceptive and unfair lending practices. AARP has published several reports on the issues involved and measures needed to protect consumers from these lenders' most egregious practices. *See, e.g.*, Sharon Hermanson & George Gaberlavage, AARP, *The Alternative Financial Services Industry* (2001), and Elizabeth Renuart, AARP, *Payday Loans: A Model State Law* (2000). AARP also has assisted in state legislative efforts to enact protections for consumers involved in these transactions, and has filed *amicus curiae* briefs urging courts, including the Florida Supreme Court in this case, to uphold these protections, especially in the face of lenders' claims they do not make loans and their other ruses to avoid compliance with interest limits and other statutes.

AARP believes the Florida Supreme Court was correct in ruling that a court, not an arbitrator, should decide whether a contract containing an arbitration provision is illegal, and

therefore void, under state law. To allow otherwise effectively puts the cart before the horse, giving an arbitrator authority to make a ruling about a contract that, if found void, could not have conferred any authority on the arbitrator. This Court's ruling in *Prima Paint Corp. v. Flood & Conklin Mfg. Corp.*, 388 U.S. 395 (1967), does not direct a different outcome, and the federal Circuit Courts that have held otherwise have failed to properly consider the difference between void and voidable contracts. Those courts also have created an untenable distinction between situations in which a contract was not formed because the parties have not mutually assented to terms, and situations involving void transactions in which a legal contract was never formed.

AARP believes Respondents will thoroughly brief those issues, and accordingly submits this brief to assist the Court by discussing key loan products in the "fringe banking" market and the harm to Florida's and other states' vulnerable borrowers if these lenders can use contracts that are *illegal*, and void, under state law to evade compliance with state usury limits and, at the same time, preclude borrowers from challenging their unlawful practices in court.

SUMMARY OF ARGUMENT

Low-income consumers and those whom mainstream lenders consider "high risk" often cannot find credit in the traditional market and rely on high-cost lenders and non-traditional sources of credit, collectively referred to as the "fringe banking" industry or "alternative financial sector" (AFS). Payday loans, refund anticipation loans (RALs), and automobile title pawns are the most common products offered in this market, typically at triple digit and higher annual percentage rates (APRs). The fringe banking industry targets low-income and working poor consumers, minorities, enlisted military personnel and those with blemished credit histories -- consumers most vulnerable to exploitation and least able to protect their interests. This has resulted in a two-tiered economy, often referred to as a system of "financial apartheid" or a "second-class" market, in which middle-income and affluent consumers are served by federally-insured and

regulated banks and other lenders, and the poor and near-poor are relegated to expensive and, in many cases, poorly regulated alternatives. *See* Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. Rev. 589, 591 (2000) [hereinafter *Two-Tiered Marketplace*].

These consumers often have little choice but to turn to these lenders due to their limited bargaining power and financial desperation, and are among those with the greatest need for a market that operates with integrity and the enforcement of usury and other laws enacted for their especial benefit. The Florida legislature saw fit to protect these necessitous borrowers from predation by enacting Chapter 687 of the Florida Statutes, which criminalizes loans made at rates that exceed 25% per annum, and provides misdemeanor or felony sanctions depending on how much the rate exceeds that limit. In order to evade statutes such as this one, fringe lenders historically have characterized their products in various guises; Petitioner, for example, maintained it was not making loans but merely was charging a fee for a check cashing service. Florida courts have a long history of recognizing the role of usury laws to protect borrowers, as well as looking at the substance of a transaction to determine if it is designed to evade usury laws. *See, e.g., Chandler v. Kendrick*, 146 So. 551, 552 (Fla. 1933) (purpose of usury laws is to "bind the power of creditors over necessitous debtors and prevent them from extorting harsh and undue terms in the making of loans."); *Beacham v. Carr*, 166 So. 456, 459 (Fla. 1936) (to frustrate such evasions "'courts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that mere form is immaterial, but that it is the substance which must be considered.'") (citation omitted).

The Court should affirm the Florida Supreme Court's ruling in order to effectuate the statutory scheme enacted by the state legislature to protect vulnerable borrowers from overreaching by lenders. To do otherwise will allow businesses to continue to enforce void, illegal contracts and to prevent courts from scrutinizing their actions.

ARGUMENT

I. STATE LAWS MUST PROTECT VULNERABLE CONSUMERS EXPLOITED BY FRINGE LENDERS.

A. The Nature of the Marketplace.

In order for the Court to fully appreciate the implications of its decision, it is important to understand the nature of the market in which payday loans are made. These loans are part of an industry popularly referred to as "fringe banking" or the "alternative financial sector" (AFS). *See* Roger Swagler, et al., *The Alternative Financial Sector: An Overview*, 7 Advancing the Consumer Interest 7, 7 (Fall 1995); John R. Burton, et al., *The Alternative Financial Sector: Policy Implications for Poor Households*, 42 Consumer Interests Annual 279, 279 (1996). Fringe bankers target low-income, working poor, and minority consumers, and those with blemished credit histories, who cannot access traditional sources of money, credit, or certain consumer goods. While many consumers have other ways to obtain short-term, unsecured loans, such as credit cards and checking accounts with overdraft lines of credit, the poor and near-poor cannot access these sources. Coupled with the decline in the availability of small, unsecured loans from banks and finance companies, many consumers with modest incomes or impaired credit find fringe bankers their only source of credit.

During the last year or so, the government has focused increased attention on fringe bankers as they have targeted a fertile new market of vulnerable consumers – the nation's military personnel. For example, The Service Members Anti-Predatory Lending Protection Act, H.R. 97, 109th Cong. (2005), would cap APRs at 36% and place new limits on loan renewals and disclosures. Senators Dole, Durbin, and Nelson have introduced SA 1523 which would amend S.1042, a bill to authorize appropriations for fiscal year 2006 for military activities of the Department of Defense. The amendment addresses consumer credit extended to service members and their dependents and would, among other things, impose the same cap. 151 Cong. Rec. S8836, S8866, 2005 WL 1719568 (2005). A recent newspaper commentary highlighted the

problem: "military bases are under siege by an army of financial predators known as 'payday lenders.' . . . Military towns are the favorite hunting grounds of the payday lenders for one very good reason -- these lenders have become rich by victimizing service people and their families with short-term loans at usurious interest rates." Ronald A. Duchin, *Predatory lenders stalk our troops*, Wash. Times, June 28, 2005, at A14, *available at* www.washingtontimes.com/commentary/20050627-090226-9305r.htm. As seen in other situations,

> [e]ven in states where payday lending is illegal it often flourishes anyway with lenders thinly disguising their operations or just simply ignoring the law. With our servicemen and -women putting their lives on the line for America in two war zones, it's way past time that America counterattacks to protect servicepeople from this kind of financial abuse at home. . . . Service people are by no means the only victims of payday lenders, but they are an easy target, especially in wartime. The disruption of overseas deployment causes financial stress for families. . . . With bills mounting for the folks at home, there's the constant temptation to raise some quick cash through a payday lender.

Id.

Describing the typical payday transaction, the commentary draws an analogy to "criminal loan sharking rings" that hook victims with short-term loans at usurious interest rates, "and when the victim can't pay, keep bleeding him or her with mounting interest charges and expanded loans. The shocking difference between loan sharks and payday lenders is that the loan sharks' typical annual 250 percent interest is considerably less than what payday lenders collect." *Id.*; *see also* Amanda Van Benschoten, *Military Targets -- Scams Aim at Soldiers*, Sunday Challenger, July 24, 2005, at 1A, *available at* http://www.challengernky.com/articles/2005/07/25/around_nky/doc42e14a4b75e75296734289.txt (describing state legislation that would restrict high payday lending rates and overpriced life insurance and noting that Kentucky State

Treasurer Jonathan Miller described members of the military as "'sitting ducks' for people hoping to make a quick buck from their steady income and financial naivete," and stated that the "'bad guys' [have] picked these military families, because a lot of them are distracted by the war, and they're very young . . . and [t]hey've become an all-too-common victim.'"); Terri Lukach, *DoD Cautions Servicemembers Against 'Loan-Shark' Lenders*, Am. Forces Info. Serv., June 17, 2005, http://www.defenselink.mil/news/jun2005/20050617_1762.html (according to John Molino, deputy undersecretary of defense for military community and family policy, payday loans are the most prevalent type of loan-shark lending affecting military families; Molino noted that payday lenders set up their businesses "'right outside the gate'" of military installations and that the high use of payday loans makes the "potential for detrimental impact on mission accomplishment . . . very real. 'The effects are long-lasting and go deep into a person's performance; it affects unit readiness.'").

Well aware that they are one of the few sources of cash for these consumers, fringe lenders maintain they merely are filling the gap created by traditional lenders. *See, e.g.*, Br. for Community Fin. Servs. Ass'n of Am. as *Amicus Curiae* Supporting Petitioner at *5-6, *Buckeye Check Cashing, Inc. v. Cardegna*, No. 04-1264, (U.S. Aug. 12, 2005), 2005 WL 1941281 (stating that studies show "payday advances satisfy an unfulfilled demand for small denomination, short-term credit" and that borrowers find the loans beneficial).[2/] Even if this

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[2/] The cited studies, Gregory Elliehausen & Edward Lawrence, Georgetown Univ. Credit Research Center, *Payday Advance Credit in America: An Analysis of Customer Demand*, Apr. 2001, *available at* www.msb.edu/prog/crc/order/mono35.pdf, and Patricia Cirillo, Cypress Research Group, *Payday Advance Customer Satisfaction Survey*, May 2004, have been criticized as being neither objective nor scientifically sound. The former was supported in part by a grant from *amicus curiae* CFSAA, and the latter was undertaken on behalf of CFSAA. *See* John Ruoff, South Carolina Fair Share, *The Cypress Research Group Study of Payday Loan Customers*, July 2005 (taking issue with study's estimates of borrowers' demographic

(continued...)

were a legitimate argument, and AARP does not concede that it is, the provision of a necessary service neither justifies the practices that harm the very consumers these lenders claim to help nor supports thwarting the legal protections enacted for their benefit. Moreover, no level of customer satisfaction justifies an illegal transaction.

A primary segment of the fringe market offers products that allow consumers to obtain a relatively small amount of cash with repayment deferred for a relatively short period, usually two weeks. The three main forms of these cash advances – payday loans, refund anticipation loans (RALs), and auto title pawns – are extremely expensive, typically imposing triple digit annual percentage rates (APRs), far in excess of state usury limits. Even in states with permissive payday loan laws, the industry seems unable to comply with federal and state laws or even the industry's own "best practices." *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 Minn. L. Rev. 1, 26-98 (2002).

In addition to high APRs, fees paid for "roll overs," when the borrower cannot repay the loan and pays another fee to extend the loan period, lead to significantly higher costs that borrowers can ill afford, and to an even greater gap between the cost of these loans and mainstream sources of credit. *See* Woodstock Inst., *Unregulated Payday Lending Pulls Vulnerable Consumers Into Spiraling Debt*, Reinvestment Alert, Mar. 2000, at 4. Moreover, rollovers often result in finance charges that exceed the original amount borrowed, and the borrower still owes the face amount of the check. This

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[2] (...continued)
and socio-economic characteristics and representations regarding satisfaction based on, among other things, shortcomings endemic to telephone surveys and the fact that only 2,000 of the sample of 17,571 customers with at least one loan between Jan. 2, and April, 15, 2004 responded) and John Ruoff, South Carolina Fair Share, *The Credit Research Center Study of Payday Loan Customers*, June 2005 (making similar criticism where only 427 (8%) of sample of 5,365 customers of CFSAA members completed the survey).

problem was illustrated in *Turner v. E-Z Check Cashing*, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999), in which a payday lender advanced $300.00 in return for the borrower's $405.00 check. The borrower could not afford to repay the $405.00 at the end of one month, and ended up paying monthly service charges of $105.00 for the next eight months ($840.00) because she could not repay the original $405.00 debt. *See also Johnson v. The Cash Store*, 68 P.3d 1099 (Wash. Ct. App. 2003) (involving a borrower who wrote a post-dated check for $575.00, received $500.00, and did fifteen rollovers in seven months, each time paying $75.00; she thus paid $1125.00 *in fees alone* for a $500.00 loan). The Florida legislature recognized this problem and, in enacting the Deferred Presentment Act provided that "[n]o deferred presentment provider or its affiliate may engage in the rollover of any deferred presentment agreement." Fla. Stat. § 560.404(18) (2002).

B. The Evolution of Payday Loans Shows Their Abusive Nature.

1. Payday Lenders & Their Antecedents Always Have Used Exploitative Practices

Payday loans have direct precursors in loans made against a borrower's wages. As salaries increased to the point they covered necessities and provided a surplus to pay principal and interest on debts, "prospective salaries and wages became assets, however inchoate, against which loans could be made." Rolf Nugent, *The Loan-Shark Problem*, 8 Law & Contemp. Probs. 3, 4 (1941). The "five-for-six-boys" lent $5.00 at the beginning of the week, to be repaid with $6.00 on the borrower's next payday, one or two weeks later. *See Two-Tiered Marketplace*, *supra*, at 618. In some instances, "salary buyers" would "buy" the borrower's next wage packet at a discount, for example, advancing $22.50 in exchange for the "sale" of a $25.00 paycheck two weeks later (with an APR of 311%). *Id.* at 618-19. Another practice involved having the borrower sign a check covering the loan principal and interest. The check was drawn on a bank in which the borrower did not have an account, and the lender said it would not cash the check

but would hold it as "security" and return it to the borrower when the loan was repaid. If the borrower defaulted, the lender deposited the check and threatened to prosecute the borrower when the bank refused payment. *See* Joe B. Birkhead, *Collection Tactics of Illegal Lenders*, 8 Law & Contemp. Probs. 78, 86 (1941).

These loans were short-term, with two weeks being the most common period. William H. Simpson, *Cost of Loans to Borrowers Under Unregulated Lending*, 8 Law & Contemp. Probs. 73, 73 (1941). While the interest rates on these loans were usurious, borrowers generally did not know their rights or have access to court, resulting in few challenges. "The one who suffers most at the hands of high-rate lenders is the borrower, yet he is almost the only member of society who has done nothing about his plight." *Two-Tiered Marketplace*, *supra*, at 619-20 (citing George L. Gisler, *Organization of Public Opinion for Effective Measures Against Loan Sharks*, 8 Law & Contemp. Probs. 182, 182 (1941)).

Despite the high cost, people in financial distress renewed these small loans, entering a downward spiral mirrored by today's payday borrowers. *Id.* at 620. The borrowers' dire situation led to legislation to regulate the lenders, producing a legal framework that permitted a high enough return to attract legitimate businesses into the small loan market, with sufficient safeguards to prevent the abuses that prevailed among "loan sharks." *Id.* at 621 (citing Frank B. Hubachek, *Annotations on Small Loans: Based on the Sixth Draft of the Uniform Small Loan Law* 1-3 (1938)). Lenders argued that these transactions involved property purchases that were not governed by usury laws, but the Uniform Small Loan Laws adopted by many states between 1916 and 1935 defined them as cash lending, subjecting them to small loan regulation. *See* John P. Caskey, *Fringe Banking: Check Cashing Outlets, Pawn Shops, and the Poor* 31-32 (1994). Every state except Arkansas enacted small loan laws, with Arkansas capping interest in its constitution. *See Two-Tiered Marketplace*, *supra*, at 621.

2. Payday Loans Are Costly and Exacerbate Borrowers' "Debt Trap"

Payday loans typically involve the borrower writing a personal check payable to the lender and receiving cash minus a fee. The borrower and lender both know the borrower does not have sufficient account funds to cover the check, and the lender agrees to hold the check until the borrower's next payday or another designated date. At the end of the initial loan term, usually one or two weeks, the borrower can redeem the check by paying the face amount, allow the check to be cashed, or refinance ("roll over") the loan by paying another fee. Payday loans are marketed as a quick, easy way to obtain cash. Borrowers need only maintain a personal checking account, be employed for a specified period with their current employer, and show a pay stub and bank statement. Payday lenders do not make inquiries routinely made by mainstream lenders, *e.g.*, credit checks, examinations of the borrowers' ability to repay, assessments of the borrowers' debt-income ratio. A key element of these loans is extremely high interest rates and associated costs. A recent report found typical APRs on two-week loans ranging from 390% to 780%, despite much lower state interest caps. Jean Ann Fox, Consumer Fed'n of Am., *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury* 2 (2004).

Senator Joseph Lieberman hosted a December 1999 payday lending forum and unveiled two charts which show it is virtually impossible for an average family to repay a payday loan when it comes due. One chart showed that a family with a household income of $35,000 and typical deductions (*e.g.*, taxes) and expenses (*e.g.*, food, housing) could not repay a loan as small as $168 at the end of two weeks. *See* Nat'l Consumer Law Center, 18 *NCLC Reports: Consumer Credit and Usury Ed.* 13-14 (2000). This helps illustrate the fiction that lenders intend the loans to be repaid in two weeks; instead, the industry is based upon the knowledge that rollovers will be necessary. As illustrated above, rollovers lead to significantly higher costs that borrowers can ill afford and create a "debt treadmill" that exacerbates the borrower's financial situation. A recent study noted: "[b]ecause of the high fees and very short terms,

borrowers can find themselves owing more than the amount they originally borrowed after just a few rollovers within a single year." Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 Econ. Dev. Q. 8, 19 (2003) [hereinafter *Chronic Borrowing*]. The authors conclude that "the business practices pursued by many payday loan companies can have the same wealth-depleting effect on financially fragile families as other abusive consumer credit practices." *Id.* at 25.

Similar problems result when lenders, sometimes to circumvent state restrictions such as Florida enacted on rollovers, allow "back-to-back" transactions in which borrowers pay off their first loan but must immediately take out another loan to meet their financial needs until their next payday. *See* Keith Ernst, et al., Center for Responsible Lending, *Quantifying the Economic Cost of Predatory Payday Lending* 3 (2004), *available at* www.responsiblelending.org/pdfs/CRLpayday lendingstudy121803.pdf. "[P]ayday lenders collect the vast majority of their fees from borrowers trapped in a cycle of repeated transactions. . . . This cycle (the 'debt trap') locks borrowers into revolving, high-priced short-term credit instead of meeting the need for reasonably priced, longer-term credit." *Id.* at 2. Moreover, if these loans really were meant to address a temporary need for a small amount of money "one would expect to see industry revenues driven by one-time or other limited-use borrowers. For borrowers taking out five, ten, or even twenty or more loans per year, payday lending functions as chronic debt, instead of helpful credit." *Id.* at 6 (footnotes omitted). *See also Chronic Borrowing*, *supra*, at 25 ("despite its expanding customer base and notwithstanding industry denials, the financial performance of the payday loan industry, at least in North Carolina, is significantly enhanced by the successful conversion of more and more occasional users into chronic borrowers."); Ill. Dep't of Fin. Insts., *Short Term Lending Final Report* 6 (1999) (on file with AARP) ("Customers rarely borrow a single time, in fact, repeat business is the main source of revenue. A single licensee may have a limited customer base, but if the customer regularly refinances a loan the store may be quite profitable.").

There has been an explosive growth in payday lending since the industry emerged in the early 1990s. *See* Scott A. Schaaf, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. Banking Inst. 339, 339 (2001) [hereinafter *From Checks to Cash*]. An Arkansas investment firm recently predicted a base of 22,000 stores generating $6 billion annually *in fees alone*. Stephens, Inc., *Undiscovered Companies Serving Underbanked and Unwanted Consumers*, The 3U Consumer Fin. Monthly 2 (Mar. 29, 2004). It also forecast a growth of 12-18% and annual loan volume of $40 billion. *Id.*

This growth has been tied to the deregulation of the banking industry, the absence of traditional lenders in the small loan, short-term credit market, and the elimination of interest rate caps. *See* Lisa B. Moss, *Modern Day Loan Sharking: Deferred Presentment Transactions & The Need For Regulation*, 51 Ala. L. Rev. 1725, 1732 (2000). Deregulation in the 1980s led banks to eliminate less profitable services, such as free checking and small balance accounts, leaving millions of low-income households with little access to free financial services. *Id.* As mainstream institutions moved out of this market due to higher returns on larger loans, payday lenders filled the void. *Id. See also From Checks to Cash*, *supra*, at 340-41.

In addition to an increase in stand alone payday lenders, the surge in the number of loans also can be attributed to the entry into the market of check cashing outlets, convenience stores, gas stations, and pawn shops, as well as offers on the Internet. *See* U.S. Pub. Interest Research Group & Consumer Fed'n of Am., *Show Me the Money! A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures* 8 (2000), *available at* http://.uspirg.org/reports/paydayloans2000/showmethemoneyfinal.pdf. *See also* Jean Ann Fox & Anna Petrini, Consumer Fed'n of Am., *Internet Payday Lending: How High-priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections* (2004), *available at* www.consumerfed.org/internet_payday_lending113004.pdf (surveying 100 Internet sites offering payday loans and finding rapid growth in websites

marketing and/or delivering small loans; also finding lenders often bypass state usury and other laws by operating without state licenses or locating in states without meaningful restrictions and claiming loans are subject to home state's law regardless of protections in borrower's state).

C. Usury Laws Must Be Enforced to Protect Consumers From Fringe Bankers' Exploitative Practices.

Florida consumers and those in other states benefit from strong marketplace protections that enhance their economic security. The growth of the fringe banking, specifically targeting consumers most vulnerable to predatory practices and least able to protect themselves from abuse, warrants stronger regulation and the rejection of exploitative lenders' attempts to evade these protections. Fringe banking customers frequently are at a distinct disadvantage because of limited education, bargaining power, and financial desperation. Vulnerable consumers like these need special protection, a role served by usury laws which have, for centuries, been enforced to "protect the needy from the greedy." *Two-Tiered Marketplace*, *supra*, at 657.

The problems presented by fringe bankers have been acute in Florida and the legislature has acted when it learned of the need to curb abuses despite the usury law. In 1993, the Florida Comptroller created a "Money Transmitter Task Force" to determine "whether the money transmitter industry should be subjected to enhanced government regulation in Florida." Letter from Douglas E. Ebert, Chairman, to The Honorable Gerald Lewis, Comptroller of Florida (Nov. 1994) (accompanying *Comptroller Gerald Lewis Money Transmitter Task Force Final Report*). The Task Force "determined that regulation was necessary and provided the Comptroller with specific statutory and administrative guidelines upon which the industry should be regulated. These recommendations came in the form of proposed legislation" which was enacted in 1994. *Comptroller Gerald Lewis Money Transmitter Task Force Final Report* 3 (Nov. 1994). The law gave the state Division of Banking and Department of Banking and Finance regulatory authority over

the money transmitter industry, defined broadly to include check cashers. *Id.* at 1. The Task Force found a significant increase in the number of check cashers in Florida, noting the "yellow pages listings for check cashers grew by 110 percent . . . between late 1988 and early 1992, at a time when the industry grew by 11 percent in the state of Illinois and 22 percent in the state of New York." *Id.* at 6.

That the Task Force Final Report was silent about payday lending through deferred presentment transactions was not surprising, given representations made by industry representatives during Task Force meetings. For example, a Task Force member who was President of the Florida Check Cashers Association stated payday loans were not a "real problem."

> We as an association have taken a strong stance against it. Don't do it. This is usurous [sic]. . . . You're providing a loan and it's just a bad situation. So we have told people not to do it. If it is a member that is doing it, we boot them out. If we have information we will notify the State Attorney in that area that they are doing that.

Task Force Meeting, Sept. 2, 1993, at 168 (statement of Joseph M. Doyle).

A leading expert on check cashing and payday lending cautioned the Task Force against allowing check cashers to make payday loans:

> If you allow check cashing outlets to make payday loans where they're essentially in the small loan business, that is an area where there has historically been a great deal of abuse, consumer abuse. . . . [T]here is a strong need for consumer protection laws and also in collection policies. So I think the state should reasonably take the choice by saying that's something we want the check cashers to stay out of,

> leave that to the loan industry which is regulated in a different way.

Task Force Meeting, Oct. 5, 1993, at 225 (statement of Professor John P. Caskey). Mr. Doyle responded that his association wholeheartedly agreed with everything the Professor said. "The payday loans, we've talked about in previous meetings. We're totally against that in Florida. Anything we can do to make it an illegal activity we're totally supportive of. . . . Well, if they're going to make loans they should get a license to do loans, period." *Id.* at 225-26 (statement of Mr. Doyle).

Check cashers promptly began to engage in payday lending, almost mimicking Professor Caskey's testimony by claiming they simply were "cashing checks" in accordance with the Money Transmitters' Code. The Florida legislature subsequently passed the Deferred Presentment Act, §§ 560.401 to 408, Fla. Stat. (2002), to, among other things, "prevent fraud, abuse, and other unlawful activity associated with deferred presentment transactions." *Id.* at § 560.408.

While the Deferred Presentment Act is a recent enactment, Florida has long recognized the role usury laws play to protect borrowers from unfair lending practices. Seventy years ago the Florida Supreme Court noted: "The very purpose of statutes prohibiting usury is to bind the power of creditors over necessitous debtors and prevent them from extorting harsh and undue terms in the making of loans." *Chandler v. Kendrick*, 146 So. 551, 552 (Fla. 1933). *See also Jersey Palm-Gross, Inc. v. Paper*, 658 So. 2d 531, 534 (Fla. 1995) ("The Florida Legislature enacted Chapter 687, Florida Statutes (1993), to protect borrowers from paying unfair and excessive interest to overreaching creditors."); *Stubblefield v. Dunlap*, 4 So. 2d 519, 521 (Fla. 1941) ("it is entirely proper for us to bear in mind not only the letter but the spirit of the usury law and its prime purpose to protect needy borrowers by penalizing unconscionable money lenders.").

Inequalities between lenders and borrowers are more pronounced in the fringe banking sector than in the mainstream

consumer credit marketplace, and consumers who resort to these products are among those with the greatest need for a marketplace that operates with integrity and the enforcement of laws state legislatures intended for their protection. Fringe bankers should not be allowed to enforce illegal contracts by evading usury limits enacted to protect necessitous consumers from exploitative practices.

CONCLUSION

Amicus curiae AARP respectfully urges the Court to affirm the Florida Supreme Court's ruling that a court must determine whether a contract containing an arbitration clause is illegal and void under state law.

September 23, 2005

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Supreme Court, U.S.
FILED
AUG 12 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN CARDEGNA, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF FLORIDA

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND THE AMERICAN FINANCIAL SERVICES ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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IN THE

Supreme Court of the United States

No. 04-1264

BUCKEYE CHECK CASHING, INC.,
Petitioner,

v.

JOHN CARDEGNA, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF FLORIDA

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND THE AMERICAN FINANCIAL SERVICES ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF *AMICI CURIAE*[1]

The Chamber of Commerce of the United States of America ("the Chamber") is the world's largest business federation, representing an underlying membership of more than three million businesses, state and local chambers of commerce, and professional organizations. Chamber members operate in every sector of the economy and transact business throughout the United States. A central

[1] Letters of consent from both parties have been filed with the Clerk of the Court. Pursuant to Rule 37.6, *amici* state that no counsel for a party authored any part of this brief, and no person or entity other than *amici*, their members, or their counsel made a monetary contribution to the preparation or submission of this brief.

function of the Chamber is to represent the interests of its members in important matters before the courts, Congress, and the Executive Branch. To that end, the Chamber has filed *amicus curiae* briefs in numerous cases that have raised issues of vital concern to the nation's business community. For example, the Chamber has previously filed briefs concerning arbitration issues before this Court in *Green Tree Financial Corp.* v. *Bazzle*, 539 U.S. 444 (2003), and *PacifiCare Health Systems, Inc.* v. *Book*, 538 U.S. 401 (2003).

The American Financial Services Association ("AFSA") was organized in 1916 and represents more than 300 companies that engage in lending and sales financing amounting to approximately twenty percent of all consumer credit in the United States. These companies range from independently-owned consumer finance firms to the nation's largest financial services, retail, and automobile sales finance companies. AFSA's membership includes national and state banks that operate multi-state consumer credit programs. Like the Chamber, AFSA represents the interests of its members in cases of importance to its members, and has filed amicus briefs in a number of cases involving arbitration issues, including *Bazzle*, 539 U.S. 444, and *Green Tree Financial Corp.-Alabama* v. *Randolph*, 531 U.S. 79 (2000).

Many of the members, constituent organizations, and affiliates of the Chamber and AFSA have adopted, as standard features of their business contracts, provisions that provide for the arbitration of disputes arising from or related to such contracts. They use arbitration because it is a fast, fair, and inexpensive method of resolving disputes with consumers and other contracting parties. Because the Chamber and AFSA members who utilize arbitration agreements may be sued in a wide range of state and federal courts, they rely on the protection afforded by the Federal Arbitration Act to ensure that their arbitration agreements are enforced consistently.

SUMMARY OF THE ARGUMENT

The only question in this case is whether a court or an arbitrator should resolve an allegation that a contract is void for illegality when that contract contains an arbitration provision. This Court answered that question in *Prima Paint Corp.* v. *Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967). Quoting the Federal Arbitration Act ("FAA"), the *Prima Paint* Court found that the arbitrator should resolve contractual issues as long as "'the making of the agreement for arbitration'" was not at issue. *Id.* at 403 (quoting 9 U.S.C. § 4).

In this case, the Florida Supreme Court failed to follow *Prima Paint*. Instead, it held that an allegation that a contract is void (rather than voidable) should always be heard by a court—even when the parties unquestionably agreed to arbitrate any disputes. This effort to redraw the line between litigation and arbitration conflicts with *Prima Paint* in at least three ways. First, it is circular: it assumes that plaintiffs will prove the contract is void in order to justify litigation of the claim the contract is void. Second, the void/voidable distinction conflicts with the analysis required under *Prima Paint* when applied to claims that a contract is void because a particular contractual provision is illegal. Third, the Florida Supreme Court's approach improperly exalts state-law considerations over the federal substantive law governing arbitrability.

The ruling below also conflicts with the purposes of the FAA by slowing enforcement of arbitration agreements when the FAA seeks to "move the parties . . . into arbitration as quickly and easily as possible." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983). As the dissent below pointed out (Pet. App. 23a), it evidences "a basic mistrust of arbitration," at odds with the "liberal federal policy favoring arbitration agreements." *Moses H. Cone*, 460 U.S. at 24. And the reliance on state-law distinctions between void and voidable contracts introduces substantial uncertainty and variability for

businesses that rely upon the FAA to ensure the consistent enforcement of arbitration agreements.

ARGUMENT

I. *PRIMA PAINT* REQUIRES ENFORCEMENT OF ARBITRATION AGREEMENTS UNLESS THE MAKING OF THE ARBITRATION AGREEMENT IS CHALLENGED

This case centers on the question of whether a court should enforce an arbitration provision when a party claims the contract in which the provision is found is void. While most contractual provisions may be enforced (or not) *after* the resolution of claims that the contract is void, an arbitration provision can have its intended effect only if enforced *prior* to such a resolution. This timing problem means that a decision about the enforceability of an arbitration provision cannot rest upon the resolution of the voidness claim, but instead requires a policy choice about when arbitration provisions should be enforced.

Through the FAA, "Congress has provided an explicit answer" to this policy question. *Prima Paint*, 388 U.S. at 403. The FAA requires that a court "order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue.'" *Id.* (quoting 9 U.S.C. § 4) (alteration in original). Accordingly, "an issue which goes to the 'making' of the agreement to arbitrate," *id.*, such as forgery or lack of authority to enter into the arbitration agreement, may be adjudicated by the court. All other claims must be arbitrated. *See id.* at 403-404. As this Court explained in *Prima Paint*, "in so concluding, we not only honor the plain meaning of the statute but also the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Id.* at 404.

Applying the FAA to the fraud claim before it, the Court in *Prima Paint* concluded that a court should hear a claim of fraud "in the inducement of the arbitration clause

itself," but not "claims of fraud in the inducement of the contract generally." 388 U.S. at 404. In drawing this distinction, the Court adopted the view, expressed in a prior decision of the Second Circuit, that "arbitration clauses as a matter of federal law are separable from the contracts in which they are embedded." *Id.* at 402 (citing *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959)); *see also id.* at 422 (Black, J., dissenting) (noting that the Court accepted the Second Circuit's reasoning). This severability doctrine allows the arbitration provision to rise or fall independently from any challenge to the rest of the contract.[2]

II. THE FLORIDA SUPREME COURT'S DECISION IS INCONSISTENT WITH *PRIMA PAINT*

In this case, the Florida Supreme Court rejected the policy choice made by Congress and explicated in *Prima Paint*. While *Prima Paint* explains that a court's inquiry is limited to issues "relating to the making and performance of the agreement to arbitrate," 388 U.S. at 404, the Florida Supreme Court chose to draw a different line, holding (Pet. App. 7a) that while an arbitrator may decide claims that the underlying contract is *voidable* under state law, a court should decide claims that the contract is *void ab initio*. That holding suffers from at least three flaws. First, it is circular: it assumes that plaintiffs will prove the contract is void in order to justify litigation of the claim that the contract is void. Second, the void/voidable distinction conflicts with *Prima Paint* when applied to claims that a particular contract provision is illegal. Third, it improperly exalts

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[2] *Prima Paint*'s severability rule also ensures that the enforceability of arbitration clauses does not depend on whether contracting parties choose to memorialize their agreements in one document or two. Instead, it treats the agreement as consisting of two documents, and only challenges that implicate the making of the arbitration provision are to be adjudicated by the courts. *See* 388 U.S. at 402-403; *cf. Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 278 (1995) (arbitrability should not turn on "happenstance" in the drafting of an agreement).

state-law considerations over the federal substantive law governing arbitrability.

A. The Florida Supreme Court Improperly Assumed Plaintiffs Would Prove That The Contract Was Void

Perhaps the best indication that the Florida Supreme Court's analysis cannot be reconciled with *Prima Paint* is its striking resemblance to the *dissent* in *Prima Paint*. The Florida Supreme Court grounded its ruling on the explanation that "if the underlying contract is held entirely void . . . all of its provisions, including the arbitration clause, would be nullified as well." Pet. App. 6a. That is the same argument Justice Black made in support of his dissenting view that fraudulent inducement challenges to a contract as a whole should be decided by courts: "[i]f the contract was procured by fraud, then, unless the defrauded party elects to affirm it, there is absolutely no contract, nothing to be arbitrated." 388 U.S. at 412 (Black, J., dissenting).

The flaw in such reasoning is that it jumps directly from the premise that litigation (and not arbitration) would be appropriate "*if* the underlying contract is held entirely void" (Pet. App. 6a (emphasis supplied)), to the conclusion that litigation is appropriate for all *claims* that a contract is void (Pet. App. 7a).[3] But that inferential leap requires either the insupportable assumptions that a plaintiff will prove his claim and that a void contract cannot include a valid arbitration provision, *see Harter* v. *Iowa Grain Co.*, 220 F.3d 544, 551 (7th Cir. 2000) (criticizing this approach); *Lawrence* v. *Comprehensive Business Services Co.*, 833 F.2d 1159, 1162 (5th Cir. 1987) (same), or a judgment that uncertainty in this context should be resolved against arbitration, and in favor of litigation. Such a judgment would reflect a policy choice fundamentally different than the one made by the FAA and reflected in *Prima Paint*.

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[3] The *Prima Paint* dissent similarly reasoned that litigation is appropriate "[i]f the contract was procured by fraud," and so all *claims* that a contract was procured by fraud must be litigated. 388 U.S. at 425.

B. The Distinction Between "Void" And "Voidable" Contracts Does Not Comport With *Prima Paint*

By permitting a court to withhold arbitration whenever a plaintiff claims that the entire contract is void rather than voidable, the Florida Supreme Court distorted the *Prima Paint* principle that arbitration should be ordered whenever the "making of the agreement for arbitration" is not at issue. That is so because the state-law concepts of "void" and "voidable" contracts do not always align with the analysis of whether a particular dispute raises an issue "relating to the making" of an arbitration agreement. 388 U.S. at 404. The term "void contract" is generally defined as "[a] contract that is of no legal effect, so that there is really no contract in existence at all."[4] This concept encompasses not only situations in which a requirement for the creation of a contract (such as assent) is absent, but also situations in which the parties reach an agreement, but that agreement is unenforceable because the law disapproves of its purpose or the terms by which it seeks to achieve such purpose.[5] In those latter situations, when the claim of voidness "challenges the *content* of the contracts, not their *existence*," the void/voidness standard reaches the wrong result under *Prima Paint*. *Bess* v. *Check Express*, 294 F.3d 1298, 1305 (11th Cir. 2002).

The conflict between *Prima Paint* and the void/voidness approach has been obscured by the fact that these two different standards yield the same result when the claim of voidness reaches "the making of the agreement for

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[4] *Black's Law Dictionary* 350 (8th ed. 2004). In contrast, a "voidable contract" is generally defined as "[a] contract that can be affirmed or rejected at the option of one of the parties; a contract that is void as to the wrongdoer but not void as to the party wronged, unless that party elects to treat it as void." *Id.*

[5] *See generally Restatement (Second) of Contracts*, § 7 & cmt. a (1981); Joseph M. Perillo, 1 *Corbin on Contracts*, §§ 1.6, 1.7 (Yale Univ. 1993); Joseph M. Perillo, *Calamari & Perillo on Contracts* §§ 1.8, 22.1 (5th ed. 2003).

arbitration." For example, a claim by a plaintiff that she did not sign a contract is a "voidness" claim, but one that relates with equal force to every provision in the contract, including any arbitration provision. This coincidence reconciles *Prima Paint* and the holdings in a line of federal court of appeals cases that allow a court to hear claims that a contract is void due to a lack of assent. *See, e.g., Three Valleys Municipal Water District* v. *E.F. Hutton & Co.*, 925 F.2d 1136 (9th Cir. 1991) (involving a claim that the signatory lacked the authority to bind another).[6]

The problem with those federal cases is that they routinely assert that *Prima Paint* was "limited to challenges seeking to *avoid* or *rescind* a contract—not to challenges going to the very existence of a contract that a party claims never to have agreed to," and that "*Prima Paint* applies [only] to 'voidable' contracts." 925 F.2d at 1140. That dicta has been applied by state courts, in cases like the one at bar, in which the voidness challenge does not reach the arbitration agreement itself, but is instead based on a state-law claim about a particular provision of the contract.[7] As every federal appeals court to consider the issue has found, application of the void/voidable distinction to deny arbitration in that context conflicts with *Prima Paint*

[6] The decisions in accord with *Three Valleys* all involved claims that a party did not assent to the contract. *See, e.g., Sphere Drake Ins.* v. *Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 32 (2d Cir. 2001) (agent allegedly acted outside scope of authority); *Sandvik AB* v. *Advent Int'l Corp.*, 220 F.3d 99, 106-107 (3d Cir. 2000) (contract was allegedly signed by an unauthorized individual); *Chastain* v. *Robinson Humphrey Co.*, 957 F.2d 851, 853, 855 (11th Cir. 1992) (defendant conceded that actual author of plaintiff's signature could not be ascertained).

[7] *See, e.g.*, Pet. App. 6a-7a (alleged violation of state usury statute); *Alabama Catalog Sales* v. *Harris*, 794 So. 2d 312, 314 (Ala. 2000) (alleged violation of usury law); *R.P.T. of Aspen, Inc.* v. *Innovative Communs., Inc.*, 917 P.2d 340, 342 (Colo. Ct. App. 1996) (alleged violation of state antitrust law); *Onvoy, Inc.* v. *Shal, LLC*, 669 N.W.2d 344, 352-354 (Minn. 2003) (alleged violation of state law concerning transactions approved by interested directors); *Nature's 10 Jewelers* v. *Gunderson*, 648 N.W.2d 804, 807 (S.D. 2002) (alleged violation of franchise registration statute).

because it permits a court to hear claims that do not reach the making of the arbitration agreement. *See Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 880-882 (11th Cir. 2005); *Bess*, 294 F.3d at 1304-1306; *Snowden* v. *CheckPoint Check Cashing*, 290 F.3d 631, 636-638 (4th Cir. 2002); *Burden* v. *Check Into Cash of Ky., LLC*, 267 F.3d 483, 488-492 (6th Cir. 2001); *Harter*, 220 F.3d at 550-551; *Lawrence*, 833 F.2d at 1161-1162; *see also Dewey* v. *Wegner*, 138 S.W.3d 591, 597-602 (Tex. App. 2004); Pet. App. 23a (Cantero, J., dissenting).

C. The Florida Supreme Court Erred In Basing Arbitrability On State Law

In concluding that a voidness claim must be adjudicated by a court, the Florida Supreme Court explained that "Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract" and "there are no severable, or salvageable, parts of a contract found illegal and void under Florida law." Pet. App. 7a-8a. This invocation of state law and policy to block arbitration is inconsistent with *Prima Paint*'s determination that the issue of arbitrability is one of "federal substantive law." *Moses H. Cone*, 460 U.S. at 24 (describing *Prima Paint*).

Indeed, *Prima Paint* itself rejected an earlier court of appeals decision holding that severability of arbitration clauses should be governed by state law. 388 U.S. at 402-403 (discussing *Lummus Co.* v. *Commonwealth Oil Ref. Co.*, 280 F.2d 915 (1st Cir. 1960)); *see also* 388 U.S. at 404-406 (holding that the FAA is an exercise of Congress's Commerce Clause powers and must be applied by federal courts even in diversity jurisdiction cases). Any state law or public policy that prevents arbitration where the FAA requires otherwise is preempted under the Supremacy Clause. *See, e.g., Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 683 (1996) (states may not impose special notice requirements on arbitration agreements); *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57-58 (1995) (arbitration agreement allowing for punitive damages

overrides state law permitting only courts to issue punitive damages awards); *Southland Corp.* v. *Keating*, 465 U.S. 1, 12-15 (1984) (prohibiting a State from requiring judicial forum for certain claims).[8]

III. THE FLORIDA SUPREME COURT'S VOID/VOIDABLE DISTINCTION UNDERMINES THE FAA

By requiring litigation, rather than arbitration, whenever a plaintiff alleges that a contract is void, the Florida Supreme Court's decision undermines the "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone*, 460 U.S. at 24-25. "[A]s a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* Whereas the rule articulated by the Florida Supreme Court precludes arbitration even when the agreement to arbitrate itself is not challenged, the FAA requires that "the parties' intentions . . . are generously construed as to issues of arbitrability." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985).

The rule established by the Florida Supreme Court stalls arbitration until after litigation on the merits of a contractual claim. This approach is at odds with "Congress's clear intent, in the Arbitration Act, to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone*, 460 U.S. at 22. In keeping with the FAA, this Court has refused to allow allegations regarding arbitration costs or biases to prevent

[8] *Southland* addressed a state statute that the California Supreme Court read to invalidate arbitration provisions in franchise agreements. *See* Cal. Corp. Code § 31512 (West 1977) ("Any condition, stipulation, or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule hereunder is void." (quoted in *Southland Corp.* v. *Keating*, 465 U.S. 1, 19 (1984))).

enforcement of an arbitration provision. *See Randolph*, 531 U.S. at 90-91 (costs); *Mitsubishi Motors*, 473 U.S. at 634 (bias). These and many other decisions by this Court recognize that a rule that requires substantial pre-arbitration litigation "risks the very kind of costs and delay through litigation that Congress wrote the Act to help the parties avoid." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 275 (1995); *see also Southland*, 465 U.S. at 7 (prolonged litigation is "one of the very risks the parties, by contracting for arbitration, sought to eliminate"); *Prima Paint*, 388 U.S. at 404 ("the arbitration procedure, when selected by the parties to a contract, [should] be speedy and not subject to delay and obstruction in the courts").

Moreover, the Florida Supreme Court's opinion "evinces a basic distrust of arbitration and places the court as jealous guardian of the determination of legal issues." Pet. App. 26a (Cantero, J. dissenting). This judicial skepticism toward arbitration is at odds with a now-long line of FAA decisions by this Court rejecting "'suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants.'" *Randolph*, 531 U.S. at 89-90 (citation omitted); *see also Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (cataloguing previous cases that recognize "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum" (citation omitted)).

A. Forum-Selection Precedents Reinforce The FAA Mandate

As this Court has often observed, "an agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 519 (1974).[9] Such clauses present the same

[9] *See also Vimar Seguros y Reaseguros, S.A.* v. *M/V Sky Reefer*, 515 U.S. 528, 534 (1995) ("arbitration clauses are but a subset of . . . forum

sort of timing problem as arbitration clauses, as a court must decide whether to enforce the parties' forum-selection provision before it knows whether the underlying contract is enforceable. It is therefore illuminating to note that forum-selection clauses are enforced even when a party claims that the entire contract is void.

As with arbitration clauses, there is a strong presumption in favor of enforcing forum-selection clauses. *Compare M/S Bremen* v. *Zapata Off-Shore Co.*, 407 U.S. 1, 10 (1972) (under federal common law, forum-selection clauses "are *prima facie* valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances") *with Moses H. Cone*, 460 U.S. at 244-245 ("doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration"). Thus, courts have consistently held that a forum-selection clause is enforceable unless there is a claim that the clause *itself* was fraudulently induced.[10] Courts have been unpersuaded by claims that a forum-selection clause should be invalidated because a contract violates public policy.[11] Courts have *not* sought to carve out an exception that allows them to ignore a forum-selection clause whenever a party claims that the contract is void.[12]

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selection clauses in general"); *Mitsubishi Motors Corp.*, 473 U.S. at 629-630 ("[i]dentical considerations" govern disputes regarding forum-selection and arbitration).

[10] *See, e.g., Afram Carriers, Inc.* v. *Moeykens*, 145 F.3d 298, 302 (5th Cir. 1998); *REO Sales, Inc.* v. *Prudential Ins. Co. of Am.*, 925 F. Supp. 1491, 1493-1495 (D. Colo. 1996); *Picken* v. *Minuteman Press Int'l, Inc.*, 854 F. Supp. 909, 911-912 (N.D. Ga. 1993); *D'Antuono* v. *CCH Computax Sys., Inc.*, 570 F. Supp. 708, 714 (D.R.I. 1983); *see also Scherk*, 417 U.S. at 519 n.14 (observing that a forum-selection clause is unenforceable only if "the inclusion of *that clause* in the contract was the product of fraud or coercion" (emphasis added)).

[11] *See, e.g., Shell* v. *R.W. Sturge*, 55 F.3d 1227, 1231 (6th Cir. 1995); *D'Antuono*, 570 F. Supp. at 714.

[12] *See Shell*, 55 F.3d at 1232 (rejecting claim that trial court should have considered whether contract was void under Ohio securities registration law before applying forum-selection clause); *Grand Central Sanitary Landfill, Inc.* v. *C-E Huntington Ltd. P'ship*, No. Civ-A95-0056, 1995 WL 92377, at *2 (E.D. Pa. Mar. 1, 1995) (rejecting argument that failure to obtain required environmental permits rendered contract and forum-selection clause void); *Murray* v. *Maxus, Inc.*, No. Civ.-A-3:95CV18-A, 1995 WL 1945545, at *2 n.5 (N.D. Miss. Nov. 13, 1995) (rejecting argument that alleged violation of Mississippi contract bidding statute voided contract and prevented enforcement of forum-selection clause).

Just as courts have been willing to trust foreign fora to handle voidness claims, the FAA requires that they trust arbitrators. *See* 9 U.S.C. § 2; *Doctor's Assocs.*, 517 U.S. at 687 (Through the FAA, "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed "upon the same footing as other contracts." (citation omitted)). Indeed, the practical concerns that underlie the forum-selection clause decisions apply with equal force to arbitration provisions. As one court explained:

> If a forum clause were to be rejected whenever a plaintiff asserted a generic claim of fraud in the inducement . . . then forum clauses would be rendered essentially meaningless. That is, whenever a plaintiff had a breach of contract claim, it could defeat an otherwise clear, detailed, and comprehensive forum selection clause by simply alleging fraud as well. Such a holding would denigrate the Supreme Court's overriding mantra . . . that forum selection clauses should not be dismissed lightly.

REO Sales, Inc. v. *Prudential Ins. Co. of Am.*, 925 F. Supp. 1491, 1495 (D. Colo. 1996). This reasoning applies with the same force to the risk, enhanced by decisions like the one in this case, that parties will make voidness claims in order to evade an agreement to arbitrate.

B. Application Of State Voidness Doctrines Will Hinder Enforcement Of Arbitration Agreements

Claims that a contract is void may be brought in a broad range of contractual settings involving a wide variety of regulatory and licensing statutes. A contract may be challenged as void through allegations that it: (1) involves the commission of a crime or tort; (2) involves the violation of a state statute that provides that contravening contracts are void; (3) conflicts with regulatory or administrative statutes; or (4) is otherwise contrary to public policy. *See generally* Joseph M. Perillo, *Calamari & Perillo on Contracts*, § 22.1 (5th ed. 2003); *Restatement (Second) of Contracts* § 194 (1981). As a result, voidness claims relating to contracts that include arbitration clauses have arisen in fields as disparate as construction, telecommunications, energy, franchising, securities, casino development, tax shelters, railroad indemnification, insurance and corporate acquisitions.[13] These claims rely on a wide array of voidness theories and are grounded in disparate state and federal laws.[14] Such claims will quickly multiply if the ruling of the

[13] *John B. Goodman Ltd. P'ship* v. *THF Constr., Inc.*, 321 F.3d 1094, 1096-1097 (11th Cir. 2003) (construction contract); *Mesa Operating Ltd. P'ship* v. *Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 244 (5th Cir. 1986) (contract to purchase gas); *Nature's 10 Jewelers*, 648 N.W.2d at 805 (franchise agreement); *Fazio* v. *Lehman Bros., Inc.*, 340 F.3d 386, 394-395 (6th Cir. 2003) (securities brokerage agreement); *R.P.T. of Aspen*, 917 P.2d at 342 (mobile phone marketing agreement); *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians* v. *Kean-Argovitz Resorts*, 383 F.3d 512, 514 (6th Cir. 2004) (casino and resort development partnership); *Denney* v. *BDO Seidman, L.L.P.*, 412 F.3d 58, 63 (2d Cir. 2005) (tax consulting agreement); *National R.R. Passenger Corp.* v. *Consolidated Rail Corp.*, 892 F.2d 1066, 1067 (D.C. Cir. 1990) (railroad indemnification agreement); *Home Quality Mgmt., Inc.* v. *Ace Am. Ins. Co.*, — F. Supp. 2d —, 2005 WL 1607885, at *2 (S.D. Fla. July 1, 2005) (insurance policy); *Medtronic, Inc.* v. *ETEX Corp.*, No. Civ. 04-1355 ADM/AJB, 2004 WL 950284, at *1 (D. Minn. Apr. 12, 2004) (corporate purchase and option agreement).

[14] *See, e.g., John B. Goodman Ltd. P'ship*, 321 F.3d at 1095 (Florida contractor licensing laws); *Mesa Operating Ltd. P'ship*, 797 F.2d at 244 (Louisiana public bidding rules); *Nature's 10 Jewelers*, 648 N.W.2d at 807

Florida Supreme Court is not reversed, and the resulting proliferation of pre-arbitration litigation would burden arbitration in derogation of the purposes of the FAA.[15]

Moreover, the principles governing voidness claims are uncertain and complex. *See, e.g., Restatement (Second) of Contracts* § 194 (analysis of claims that contracts are void as contrary to public policy requires multi-step balancing test); 6 Richard A. Lord, *Williston on Contracts*, § 12.4 (4th ed. 1995). Any rule inviting litigation of such claims before enforcement of an arbitration clause entails "the very kind of costs and delay . . . that Congress wrote the [Federal Arbitration] Act to help the parties avoid." *Allied-Bruce Terminix*, 513 U.S. at 278.

Application of the distinction between void and voidable contracts will also make the enforceability of particular arbitration clauses depend on which State a challenge is brought in, since the various States have conflicting approaches on whether particular claims render a contract void or merely voidable. For example, a claim that a national mortgage lender made usurious mortgage loans would make the loans void and unenforceable in New York,

(South Dakota franchise registration laws); *Fazio*, 340 F.3d at 391 (federal securities laws); *R.P.T. of Aspen*, 917 P.2d at 342 (Colorado antitrust statute); *Match-E-Be-Nash-She-Wish Band*, 383 F.3d at 514 (federal regulations governing Indian gaming); and *National R.R. Passenger Corp.*, 892 F.2d at 1069 (general public policy concerns).

[15] The persistence of attacks on arbitration strongly suggests that any rule that allows a party to sidestep arbitration will become a commonplace litigation strategy. For example, the FAA allows unconscionability challenges to arbitration agreements in court because such challenges are generally applicable to any contract. *See* 9 U.S.C. § 2. However, now *most* unconscionability cases involve arbitration agreements. *See* Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 194-196 (2004) (finding that the total number of unconscionability cases available through computerized searches jumped from 54 in 1982-1983 to 235 in 2002-2003 and that nearly 70% of the recent cases involved claims that arbitration agreements were unconscionable compared to fewer than 15% of claims 20 years ago).

but would only require the forfeiture of excess interest in North Carolina.[16] A claim that a home contractor was not licensed would make the relevant contract void in New Mexico, but potentially only voidable in Arizona.[17] Similarly, a claim that a commercial lease is contrary to zoning laws is a voidness claim in the District of Columbia, but makes the contract neither void nor voidable in Ohio.[18]

State-by-state variation in the enforceability of arbitration agreements is at odds with the FAA, which anticipates that arbitration agreements will be equally enforceable nationwide. *See Southland*, 465 U.S. at 15 ("We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted."). Such variability would substantially impede the ability of national businesses to rely upon the consistent enforcement of arbitration agreements.

CONCLUSION

For the foregoing reasons, the judgment of the Florida Supreme Court should be reversed.

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[16] *Compare Southern Fin. Group, Inc.* v. *Collins*, 775 N.Y.S.2d 161, 162 (N.Y. App. Div. 2004) *with Swindell* v. *Federal Nat'l Mortg. Ass'n*, 409 S.E.2d 892, 893 (N.C. 1991).

[17] *Compare Gamboa* v. *Urena*, 90 P.3d 534, 537 (N.M. Ct. App. 2004) ("contracts entered into by unlicensed contractors are contrary to public policy and unenforceable"), *cert. denied*, 92 P.3d 10 (N.M. 2004), *with Bentivegna* v. *Powers Steel & Wire Prods., Inc.*, 81 P.3d 1040, 1046 (Ariz. Ct. App. 2004) ("Thus, even unlicensed contractors are not automatically barred from bringing an action for amounts due.").

[18] *Compare McMahon* v. *Anderson, Hibby & Blair*, 728 A.2d 656, 659 (D.C. 1999) *with Truetried Serv. Co.* v. *Hager*, 691 N.E.2d 1112, 1118 (Ohio Ct. App. 1997).

Respectfully submitted.

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AUGUST 2005

(3)

Supreme Court, U.S.
FILED
AUG 12 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA and DONNA REUTER,

Respondents.

On Writ of Certiorari to the Supreme Court of Florida

BRIEF OF *AMICUS CURIAE* COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*

Amicus curiae Community Financial Services Association of America ("CFSA") is the national trade association for the payday advance industry, representing the owners of more than one-half of the estimated 22,000 payday advance retail outlets in the United States. *Amicus curiae* has authored this brief in whole, and has no stake in any of the parties to this litigation.[1] *Amicus curiae* has no interest in the outcome of this case, other than in seeking, on behalf of its members, the correct and consistent application of federal law to claims such as those asserted in this action.

Amicus curiae has established – and enforces among its members – responsible industry practices and appropriate consumer rights and protections ("Best Practices"). The Best Practices of *amicus curiae* (attached as Exhibit A) require its members to comply with all applicable laws and regulations; to disclose fully the terms and cost of each transaction; to limit renewals of payday advances; to encourage consumers to use the service responsibly by informing consumers of the intended use of the product and by notifying them of credit counseling alternatives; to provide consumers with a next-day right of rescission; and to refrain from the threat or pursuit of criminal action for collection purposes.

Many payday advance providers, including Petitioner Buckeye Check Cashing, Inc. and other *amicus curiae* members, include arbitration clauses in their transaction agreements. Throughout the payday advance industry, arbitration clauses are important provisions to help speedily

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[1] Petitioner, Buckeye Check Cashing, Inc., is a member of *amicus curiae*. This brief represents the perspective of *amicus curiae* and not of any party. Petitioner has not borne any portion of the cost of preparation of this brief, other than through its payments of ordinary membership dues to *amicus curiae*. The parties have consented to the filing of this brief, and letters evidencing such consent have been filed with the Clerk of this Court, pursuant to S. Ct. R. 37.2.

resolve disputes in an inexpensive way. *Amicus curiae* believes that the interests of the payday advance industry and of the consuming public are best protected by the holdings of six federal courts of appeals, which have stated that the Federal Arbitration Act does not allow a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality. The outcome of this matter will have a long-lasting and economically powerful impact on members of *amicus curiae* as well as far-reaching implications for financial institutions, which consistently use arbitration provisions in their credit-related agreements.

Accordingly, *amicus curiae* desires to share its perspective on these issues to assist the Court in its disposition of this case.

STATEMENT OF THE CASE

Amicus curiae concurs in Petitioner's Statement of the Case.

SUMMARY OF THE ARGUMENT

The payday advance industry has become a major financial resource for millions of consumers. It is estimated that there are over 22,000 individual payday advance outlets in the United States, and that the industry provided over $40 billion in payday advances in 2003. This industry serves a void created by the withdrawal of traditional lenders from the small loan market, and its growth is a direct result of consumer demand. Payday advances compare favorably with, and are often less expensive than, other alternatives, for example, overdraft protection products and late fees. The payday advance industry is and has been heavily regulated, both at the state and federal levels. Payday advance providers are subject to state loan and/or check cashing laws, the disclosures mandated by the federal Truth-in-Lending Act, and the prohibitions on unfair

and deceptive trade practices contained in the Federal Trade Commission Act. Arbitration is important and useful in the payday advance industry, and such clauses have long been features of payday advance agreements. These clauses allow payday advance firms to resolve disputes in a low cost, quick and efficient manner. If unable to rely upon arbitration clauses in payday advance agreements, providers would be denied these beneficial procedures.

ARGUMENT

I. THE PAYDAY ADVANCE INDUSTRY SERVES A SIGNIFICANT MARKET FOR SHORT-TERM CREDIT

Respondents in this case have argued that the Court should affirm the Florida Supreme Court's judgment essentially as a way to penalize the payday advance industry. Respondents state that if the Court rules in Petitioner's favor regarding arbitration clauses in payday advance agreements, the Court "would be required to find that legally cognizable contracts existed (if they contained arbitration clauses) even if they provided for murder-for-hire, the sale of child pornography or the sale of illegal drugs[,]"[2] suggesting that, at least in the context of the legal issue involved here, payday advance agreements are indistinguishable from those types of contracts. That argument, needless to say, is both legally and factually misplaced.

The payday advance industry serves a void created by the withdrawal of traditional lenders from the small loan market and has grown rapidly to become a large part of the financial services industry. It is estimated that the number of payday advance firms rose from 10,000 in 2000 to 22,000 in 2004, and it is predicted that such rapid expansion of the industry will

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[2] Opp. To Cert. Pet. 3.

continue for at least three to five more years. In 2003, the industry provided over $40 billion in payday advances.

The typical payday advance involves a small, unsecured, short-term cash advance until the next payday for an employed worker who maintains a checking account. It is a very simple transaction with the finance charge expressed clearly as both a dollar amount and as an annual percentage rate ("APR"). To obtain such an advance, the consumer applies with very basic credit information and enters into an agreement that fully complies with applicable federal and state disclosure requirements, including disclosure of the APR. The consumer writes a personal check for the advance amount plus a finance charge and immediately receives the transaction proceeds by cash, electronic funds transfer or check. The payday advance provider holds the personal check until the borrower's payday, usually in about two weeks. Payday advances are short-term transactions and most generally are used to navigate unanticipated cash-flow problems, such as repair of an automobile needed to get to and from work; medical expenses; or an unexpected home-repair bill.

In addition to traditional lenders abandoning the small, short-term loan market, the consolidation of the banking industry has further deprived consumers of access to traditional sources of small loans. The closing of redundant bank branches has resulted in the absence of brick-and-mortar financial services storefronts in many areas of the country. Because payday advance borrowers generally have limited small-denomination sources of credit available to them, a payday advance satisfies their credit needs.

The Credit Research Center at Georgetown University's McDonough School of Business authored the first comprehensive analysis of consumer demand for, and use of,

payday advance services.[3] The study shows that payday advances satisfy an unfulfilled demand for small denomination, short-term credit. Important findings of the study include:

- 92% of borrowers view payday advances as beneficial.
- About 66% of most recent new advances were used to cover an unexpected expense or a temporary reduction in income.
- Nearly two-thirds of customers who considered other sources of credit chose a payday advance because of the quick and easy process, the fast approval and the limited paperwork; a mere 6% said that they had no other credit option.

More recently, in 2004, the Cypress Research Group conducted a study that analyzes consumer satisfaction with payday advances.[4] 2,000 payday advance customers who had obtained a payday advance within the past three months were asked about several aspects of their satisfaction with their recent payday advance. Customers surveyed stated the following:

- In comparison to other financial products with which they had recent experiences, the payday advance was among the most highly rated (75% satisfied), second only to check overdraft protection.

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[3] Elliehausen and Lawrence, "Payday Advance Credit: An Analysis of Consumer Demand," Monograph #35, Georgetown University, April 2001, http://www.msb.edu/prog/crc/order/Mono35.pdf.

[4] Cypress Research Group on behalf of CFSA. "Payday Advance Customer Satisfaction Survey," May 2004.

- They were highly satisfied with general aspects of the payday advance experience, such as the level of service during the application process (88% satisfied), the level of service while the payday advance was outstanding (85%), and the payday advance itself (82%).
- Regarding other aspects of the payday advance, 85% were satisfied with the ability to renew the payday advance, 82% were satisfied with the maximum payday advance amount allowed, and 77% were satisfied with the payday advance repayment schedule.

The results of this survey indicate strong consumer satisfaction with the payday advance industry.[5]

II. THE PAYDAY ADVANCE INDUSTRY IS COMPREHENSIVELY REGULATED

Payday advance firms are subject to both state and federal regulation. As a general rule, they may operate only in those states in which they may be licensed. Currently, 37 states and the District of Columbia have adopted such licensing statutes. The principal exception to this general rule is that some payday advance firms act as agents for commercial banks in a few states that do not otherwise license payday advance providers. In those instances, however, the payday advance firm only provides marketing and administrative services to the commercial bank, which enters into the loan agreement with the borrower and funds the loan. The activities of the banks and their agents are heavily regulated and regularly examined by the appropriate federal and state banking agencies, *e.g.* the state banking regulator and the Federal Deposit Insurance

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[5] *See id.* pp. 4-5.

Corporation for state-chartered banks that are not members of the Federal Reserve system.

State licensing statutes[6] typically impose a number of conditions on payday advance firms: limits on the overall advance amount, the term of the advance, the maximum fees that can be charged and the number of renewals. Some states also mandate "cooling off" periods between transactions, and others prohibit payday advance providers from conducting a transaction with a customer who has an outstanding payday advance from another firm.

Florida, for example, is a state that currently has laws in place that permit and regulate deferred presentment transactions (as payday advances are referred to in Florida).[7] In 1994, the Florida Legislature adopted the state's "Money Transmitters Code" (the "Code"), which requires businesses that provide currency in exchange for a check to register as a "check casher."[8] Shortly thereafter, the deferred presentment industry sought an opinion from the agency charged with applying and interpreting the Code, the Florida Department of Banking and Finance (the "Department"), regarding whether deferred presentment transactions were authorized under that law. In response, the Department issued an opinion in February 1995, in which it concluded that deferred presentment transactions were permissible under the Code as long as they were conducted in accordance with the requirements applicable to all other check-cashing transactions. That opinion was

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[6] *See e.g.* Az. Rev. Stat. § 6-1251; 815 Ill. Comp. Stat. 122 (effective Dec. 6, 2005); Ind. Code Ann. § 24-4.5-7-101; Ohio Rev. Code Ann. § 1315.39.

[7] Deferred Presentment Act, Fla. Stat. ch. 560 Part IV (2001).

[8] § 560.303(1), Fla. Stat. (Supp. 1994).

subsequently affirmed in regulations issued by the Department in 1997 that clearly provided for deferred presentment check-cashing.[9] In addition, the Code's authorization of deferred presentment check-cashing was confirmed again by a 1998 Department advisory letter as well as by an opinion of the Florida Attorney General in 2000. In 2001, the "Deferred Presentment Act," which specifically regulates deferred presentment transactions separately from other check-cashing transactions, became effective.[10] Like most state laws regulating the payday advance industry, the law requires licensing; limits overall amounts that can be advanced; establishes maximum fees that may be charged and prohibits making an advance to a customer who has an outstanding payday advance from another firm.

At the federal level, the Truth-in-Lending Act[11] and the Federal Trade Commission Act[12] are the principal laws relevant to payday advances. The Truth-in-Lending Act requires that payday advance firms disclose the cost of a payday advance in dollar amount and annual percentage terms. When the Federal Reserve Board, which implements the Truth-in-Lending Act, proposed a regulation subjecting payday advances to this disclosure requirement, *amicus curiae* filed a comment in support of the regulation. Section 5 of the Federal Trade Commission Act prohibits companies such as payday advance firms from engaging in unfair and deceptive marketing

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9 Florida Administrative Rule 3C-560.803 (Repealed 11-4-01).

10 Whether the Department exceeded the scope of its authority in interpreting the Code is currently the subject of litigation in the Florida Supreme Court. *McKenzie Check Advance v. Betts*, 2005 Fla. LEXIS 1353.

11 15 U.S.C. §§ 1601 *et seq.*

12 15 U.S.C. §§ 41 *et seq.*

practices, and empowers the Federal Trade Commission to take civil actions against any company that engages in such practices.[13]

III. ARBITRATION CLAUSES ARE AN IMPORTANT PART OF PAYDAY ADVANCE AGREEMENTS

Since the mid-1990s, the inclusion of arbitration clauses in consumer agreements has increased immensely. Congress, when it enacted the Federal Arbitration Act in 1925, and many states, through adoption of the Uniform Arbitration Act, have recognized the importance of allowing parties to agree to binding arbitration and limiting the right to appeal an arbitrator's decision in contract disputes. In the payday advance industry, arbitration clauses in consumer agreements have become standard. Given the small amount of a payday advance, arbitration is particularly well-suited to resolve disputes.

Congress has set forth the case for arbitration a number of times over the years. The Senate Judiciary Committee, when recommending passage of the Federal Arbitration Act in 1924, stated that arbitration allows parties to "avoid the delay and expense of litigation," and so appealed to "business . . . as well as to individuals."[14] In 1982, a House Committee determined that "[t]he advantages of arbitration are many; it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive . . . [and] it is often more flexible in regard to scheduling of times and places of hearings."[15] More recently, Congress stated in the Y2K Act that arbitration

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13 15 U.S.C. § 45.

14 S. Rep. No. 68-536, at 3 (1924).

15 H.R. Rep. No. 97-542 (1982).

is useful because "individuals already find [the legal] system inaccessible because of its complexity and expense."[16]

In February 2005, the National Arbitration Forum, one of the country's three leading alternative dispute resolution organizations, announced that a study conducted by Ernst & Young, entitled *Outcomes of Arbitration: An Empirical Study of Consumer Lending*,[17] confirmed that consumers find the arbitration process to be advantageous and beneficial in resolving disputes. Results of the study revealed that consumers prevail in arbitrations conducted by the National Arbitration Forum at the same rate they prevail in state court – 55%. Furthermore, as a part of the study, a survey taken of a small random sample of claimants in consumer arbitration reinforced consumer satisfaction with respect to resolution, process, cost, and timeliness of arbitration. Consequently, it is in the interest of both lenders and consumers to resolve disputes in arbitration rather than in traditional lawsuits.

The importance and usefulness of arbitration in the payday advance industry is substantial. The outcome of this case will have enormous implications not only for arbitration clauses in consumer agreements, but also contract disputes in general.

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[16] 15 U.S.C. § 6601(a)(5).

[17] http://www.arb-forum.com/EY_2005.pdf.

CONCLUSION

For the reasons set forth above, *amicus curiae* strongly supports Petitioner and urges the Court to reverse the judgment of the Florida Supreme Court.

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EXHIBIT A

Best Practices for the Industry

To be a member in good standing of CFSA, a payday advance provider must abide by the following best practices:

1. **Full disclosure.** A member will comply with the disclosure requirements of the State in which the payday advance office is located and with Federal disclosure requirements including the Federal Truth in Lending Act. A contract between a member and the customer must fully outline the terms of the payday advance transaction. Members agree to disclose the cost of the service fee both as a dollar amount and as an annual percentage rate ("APR").
2. **Compliance.** A member will comply with all applicable laws. A member will not charge a fee or rate for a payday advance that is not authorized by State or Federal law.
3. **Truthful advertising.** A member will not advertise the payday advance service in any false, misleading, or deceptive manner.
4. **Encourage consumer responsibility.** A member will implement procedures to inform consumers of the intended use of the payday advance service. These procedures will include notifying consumers that a payday advance is a short-term cash flow tool not designed as a solution for longer term financial problems and informing customers of the availability of credit counseling services.
5. **Rollovers.** A member will comply with State laws on rollovers (the extension of an outstanding advance by payment of only a fee). In States where rollovers are

not specifically allowed a member will not under any circumstances allow a customer to do a rollover. In the few States where rollovers are permitted, a member will limit rollovers to four (4) or the State limit, whichever is less.

6. **Right to rescind.** A member will give its customers the right to rescind, at no cost, a payday advance transaction on or before the close of the following business day.

7. **Appropriate collection practices.** A member must collect past due accounts in a professional, fair and lawful manner. A member will not use unlawful threats, intimidation, or harassment to collect accounts. CFSA believes that the collection limitations contained in the Fair Debt Collection Practices Act (FDCPA) should guide a member's practice in this area.

8. **No criminal action.** A member will not threaten or pursue criminal action against a customer as a result of the customer's check being returned unpaid or the customer's account not being paid.

9. **Enforcement.** A member will participate in selfpolicing of the industry. A member will be expected to report violations of these Best Practices to CFSA, which will investigate the matter and take appropriate action. Each member company agrees to maintain and post its own toll-free consumer hotline number in each of its outlets.

10. **Support balanced legislation.** A member will work with State legislators and regulators to support responsible legislation of the payday advance industry that incorporates these Best Practices.

11. **Relationships with financial institutions.** A member may market and service payday advances made by a federally insured financial institution, provided the financial institution does the following: (1) sets its own credit criteria; (2) approves and funds each advance; (3) complies with applicable State disclosure requirements, where not inconsistent with Federal law; (4) complies with applicable State law as to the number of rollovers; (5) permits the member to purchase no more than a de minimis amount of the advances, or any such other amount which may be consistent with safety and soundness determinations by Federal or State banking regulators; (6) complies with the guidelines and regulations on payday lending issued by the financial institution's Federal or State regulator; and (7) complies with these Best Practices unless the Best Practices conflict with this Paragraph, in which case the terms of this Paragraph shall apply.

12. **Military.** A member will comply with a separate code of Military Best Practices that addresses the unique circumstances of active duty military customers. These special consumer protections include, among others: a prohibition on the garnishment of military wages or salaries and on contacting the military chain of command to collect payment; and the establishment of financial literacy initiatives that will benefit service men and women.

2005

(8)

Supreme Court, U.S.
FILED
AUG 12 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,
Appellant,

v.

JOHN CARDEGNA AND DONNA REUTER ON BEHALF OF THEMSELVES AND THOSE SIMILARLY SITUATED,
Respondents.

On Writ of Certiorari to the Supreme Court of Florida

BRIEF OF *AMICI CURIAE* FINANCIAL SERVICE CENTERS OF AMERICA, INC., CALIFORNIA FINANCIAL SERVICE PROVIDERS AND THE ASSOCIATION OF OHIO CHECK CASHIERS, INC., D/B/A OHIO ASSOCIATION OF FINANCIAL SERVICE CENTERS, IN SUPPORT OF APPELLANT

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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STATEMENT OF INTEREST

The instant *amici curiae* are the Financial Service Centers of America, Inc. ("FiSCA"), a non-profit New Jersey corporation, and two of its state affiliates, the California Financial Service Providers, a California non-profit corporation, and The Association of Ohio Check Cashiers, Inc., d/b/a the Ohio Association of Financial Service Centers, an Ohio non-profit corporation. All three participating *amici curiae* are referred to as "FiSCA."[1] FiSCA is intensely concerned with

[1] Written consent to the filing of this brief has been obtained in accordance *with Supreme Court Rule* 37.3(a). This brief was prepared solely by counsel for FiSCA. No person or entity other than the *amici*

this matter because it will impact enormously on the ability of non-bank financial institutions to provide consumers with a wide variety of financial services at costs effectively established by fair market prices.

The broad scope and enforceability of arbitration clauses in supplying consumer financial services constitute two of the most vital pillars supporting rigorous competition to provide those services at the lowest possible prices. By containing the costs and business disruption attendant on consumer disputes, arbitration has fostered the development of a wide variety of differently configured non-bank financial institutions. They range from very small, single store "Mom and Pop" businesses to publicly traded companies with thousands of locations nationwide.[2] The dispute resolution mechanisms

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curiae has made a monetary contribution to the preparation or submission of this brief, except for membership dues and affiliate levies collected in the normal course of the operations of the *amici curiae* three trade associations. Appellant Buckeye Check Cashing, Inc. is a member of both FiSCA and the Ohio Association of Financial Service Centers, to both of which *amici* appellant pays only dues generally imposed on all members in the normal course of conducting the associations' regular business activities.

[2] In 1997 Coopers & Lybrand conducted a study of America's non-bank financial institutions for the United States Treasury Department. The resulting report found the check cashing industry to be "the most fragmented" segment of the non-bank financial institution industry. Coopers & Lybrand, *Non-Bank Financial Institutions: A Study of Five Sectors*, at 40 (1997). There is much greater business concentration among the single product, or "monoline", companies providing the short term, small dollar loans denominated payday advances ("PDAs"), or payday loans. As of the close of 2003, the three largest monoline PDA lenders were Advance America, with approximately 2,250 locations and CNG Financial and Check into Cash, both with about 900 stores. In contrast, the "multiline" (offering a significant diversity of financial products) segment of the PDA industry was led by Ace Cash Express with 867 stores, Cash America with 552 locations and Dollar Financial Group with 320 facilities. Stephens Inc., *Industry Report: Payday Loan Industry*, at 9 (2004).

of the *Federal Arbitration Act*, 9 U.S.C. § 1 *et seq.* ("FAA"), have made possible vigorous price and non-price competition among these businesses, many of whom are FiSCA members.

FiSCA has over 6,000 member locations, approximately two-thirds of which provide short term, low dollar value loans to consumers. Those transactions are referred to colloquially as payday advances ("PDAs") or payday loans. *Amicus curiae* Ohio Association of Financial Service Centers has 47 member companies with well over 300 financial service center locations. The California Financial Service Providers has nearly 2,000 member locations. PDAs are provided at almost all member locations of the latter two *amici curiae*. Although those *amici curiae* are state affiliates of the national trade association (*i.e.*, FiSCA), not all members of those two state associations are also members of the national association.

Amicus Curiae FiSCA has existed since 1987. Various of its state affiliates predate substantially the formation of FiSCA.[3] Established to represent the members of the growing non-bank financial services industry, FiSCA was originally known as the National Check Cashers Association. From its inception in the 1930s, largely as a response to the banking practices of the Depression era and changes in employer payment practices, the financial service center industry has evolved to become the pivotal link to the payments system for millions of Americans. These individuals opt for convenience or reasons of personal preference to use FiSCA members' facilities instead of the traditional banking system.

Just as many consumers prefer the convenience of specialty stores to large department stores, so, too, do many consumers in selecting the convenience of financial service centers over

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[3] The Financial Service Centers of New York was established in 1957. Another FiSCA affiliate, the Community Currency Exchange Association of Illinois, was founded in 1937.

banks. The importance of this convenience factor is supported by empirical research which shows that nearly 60 percent of FiSCA member customers maintain a savings or checking account at a bank or credit union. Eric Mower and Associates, *FiSCA Customer Satisfaction Research: Final Report*, at 6-10 (2000). They prefer doing business with FiSCA members because of the nearby neighborhood locations, longer hours of operation and the friendly service they receive.

The growth of the industry was stimulated, in part, by the passage of the *Depository Institutions Deregulation and Monetary Control Act of 1980*, Pub.L. 96-221 (Mar. 31, 1980), which removed deposit rate ceilings and led to explicit pricing for bank deposit services. Faced with a new banking environment, consumers demanded increased convenience and lower costs in fulfilling their financial services needs. As a result, community-based check cashing centers, which provide more convenient access to financial services, were utilized increasingly. Also, increases in fees charged by traditional banks have caused many Americans to seek less costly, fee-based options that do not require customers to maintain large average daily balances.

In 2000, FiSCA adopted its present name to reflect how traditional check cashers metamorphosed into enterprises that supplied many different products, including numerous financial services, among which are PDAs.[4] Most of the FiSCA member locations making PDAs are known as "multiline" stores. This is in contrast to "monoline" locations at which the financial transactions are limited effectively to PDAs only.

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[4] Coopers & Lybrand, *Non-Bank Financial Institutions: A Study of Five Sectors, supra* at 39.

A "multiline" PDA lender supplies the public with both PDAs and other, more traditional consumer financial products, such as:

- Wiring funds to third parties;
- Disbursing cash to money remittees;
- Selling and cashing money orders;
- Supplying bill payment services;
- Cashing checks;
- Exchanging currency;
- Selling prepaid telephone cards, bus cards and subway tokens/card;
- Offering tax preparation services; and
- Providing accounting/bookkeeping assistance to individuals and small businesses.

Various ancillary goods may be available at a neighborhood financial service center. In some instances, financial service centers are affiliated by common ownership with other enterprises, such as small grocery stores or bodegas.

Most states regulate financial service centers in one way or another, frequently using the same regulatory agencies that oversee banks and credit unions. State regulators often set rates for fees that can be charged for certain services and the marketplace also functions to keep prices low for consumers. New players are entering the market. Some banks and credit unions have opened stand alone check cashing operations. Major national retailers, such as Wal-Mart and 7-Eleven, have launched financial service facilities that provide check cashing, money wiring and money order sales. All of this has created a more competitive marketplace and additional consumer options.

Financial service centers have survived for decades despite demographic shifts, massive social changes and technological innovations. These businesses successfully adapted themselves to new commercial conditions with new products to replace out-moded product lines. Most FiSCA members are family-owned and operated enterprises. They frequently pass from generation to generation within the same family. Yet it is still fairly common to find the daughters and sons of proprietors striking out on their own in new locations with a somewhat different mix of products.

This phenomenon is facilitated by the relatively low economic barriers confronting new entrants into the industry. Most state regulations mandate only modest levels of "net worth" and "liquidity." Physical locations are normally leased, so that the most costly items are store fit-up, operating cash and regulatory compliance. In most geographic areas, a financial service center can be established and operated for an initial investment of $250,000 to $500,000.

This ease of entry into the industry always has encouraged participation by members of new immigrant groups. Hence, the ethnic background of financial service center operators includes many Hispanics, Africans, Asians and Eastern Europeans.

Because arbitration clauses invoking the FAA are standard provisions in PDA agreements under which FiSCA mem bers provide small dollar value, short term loans, this case implicates interests vital to FiSCA. As discussed below, the continued viability of small enterprises, as well as the financial health of larger lenders, is closely linked to the ready availability of arbitration proceedings under the FAA to afford consumers the swift, sure and inexpensive resolution of claims.

SUMMARY OF ARGUMENT

The judgment under review contravenes both the express terms of the FAA and the separability doctrine recognized in this Court's seminal decision in *Prima Paint Corporation v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04, 87 S.Ct. 1801, 1805-06 (1967). *Prima Paint* established conclusively that arbitration was statutorily mandated whenever "the making of an agreement to arbitrate" was proven, irrespective of any state law based challenge to the enforceability of the obligations contained in the remainder of the written contract. 9 U.S.C. §4; *Prima Paint, supra*. Congress has succeeded in its legislative goal for the FAA: fostering the growth of interstate commerce by providing consumers and merchants an inexpensive, quick and informal method for conflict resolution. Certainty encourages commerce. Without it, business investments become riskier and product costs inevitably increase.

The *ad hoc* application of state "public policy" to preclude the enforcement of a wholly valid "agreement to arbitrate," 9 U.S.C. §4, vitiates many benefits that the FAA was meant to establish. The resulting uncertainty impairs significantly the ability of FiSCA's members to sustain themselves against the prospect of incurring the ever escalating expense of proceeding in court. Consumers and enterprises of every size are best served by the vigorous enforcement of arbitration agreements. State public policy can be vindicated before arbitrators and through many other means. The shifting vagaries of fifty states' *substantive* public policy cannot justify eviscerating the federal policy of the FAA to guarantee contracting parties access to an alternative dispute resolution procedure.

ARGUMENT

I. CIRCUMSCRIBING THE FEDERAL ARBITRATION ACT'S SCOPE BY THE *AD HOC* APPLICATION OF STATE LAW WOULD DEFEAT PARAMOUNT FEDERAL INTERESTS IN FOSTERING INTERSTATE COMMERCE.

Enactment of the FAA, 9 U.S.C. §1 *et seq*., unquestionably established that the enforcement of arbitration agreements was a *national* policy. Congress utilized its authority under the Interstate Commerce Clause to serve as the foundation for the FAA. U.S. Const., Art. I, §8; see *Allied-Bruce Terminex Companies et al. v. Dobson*, 513 U.S. 265, 273-75, 115 S.Ct. 834, 839-40 (1995). Under this statute, arbitration agreements were to function as a mechanism for enhancing the economic development of the country as a whole by providing powerful assurances of stability to those who invested, conducted business and participated in interstate commerce. The FAA has served those interests effectively for the past 80 years, during which the American economy prospered to the point that it has become the world's finest engine for creating and distributing goods and services to consumers.

The ever-increasing prevalence of arbitration clauses in consumer transactions is a testament to the importance merchants attach to the availability of swift, inexpensive and non-disruptive dispute resolution under those contract provisions. Some goods and services, such as new automobiles, swimming pool installations and stockbroker services, would be both severely restricted and much more expensive if purchaser/seller disputes could not be resolved through arbitration. The same is true of the PDA industry in which the small dollar amount of each transaction (almost always less than $500) cannot coexist with the disruptive, dilatory and costly remedies prevalent in judicial forums that evolved under the

common law tradition. Mogilnicki and Jensen, *Arbitration and Unconscionability*, 19 Ga. St. U. L. Rev. 761, 768 (2003).

Saliently, the FAA reversed centuries of judicial hostility to alternative dispute resolution. This nullified long-standing shibboleths such as "the law disfavors arbitration" or that "any agreement in derogation of the court's authority violates public policy" or that "arbitration agreements are to be strictly [narrowly] construed." See *Allied-Bruce Terminex*, *supra*, 513 U.S. at 270, 115 S.Ct. at 838. Not only were those hoary principles incompatible with economic conditions in twentieth century America, but the original underlying reason for their development was eliminated effectively by the middle of the nineteenth century in a series of administrative reforms that divorced judicial compensation from the amount of fees paid by the litigants.[5] Whether the survival of the courts' residual antipathy to arbitration stems merely from a misapplication of *stare decisis* has been questioned by this Court. *Id*. Sometimes opposition to arbitration as a *procedure* may mask underlying concerns about *substantive* social policy. Cf. Paul Carrington, *Unconscionable Lawyers*, 19 Ga. St. U. L. Rev. 361 (2003).

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[5] Judges at common law were paid only nominal salaries by the crown/state. They derived the bulk of their compensation from the fees paid by the parties whose cases they heard. This arrangement extended to the puisne judges and the chief justice of the Court of King's Bench, England's highest law court. John, Lord Campbell, C.J., *The Lives of the Chief Justices of England*, Vol. IV at 37, n.1 (1873). Diversion of judicial business to arbitration threatened the judges' livelihoods, as did early resolution of the cases brought before them. Although by the dawn of the twentieth century, virtually all judicial compensation was uncoupled from the collection of litigant fees and the number of cases on the court calendar, vestiges of the old system persisted for some time. Some of these anachronisms have been struck down on federal constitutional grounds for being inconsistent with due process principles or incompatible with specific guarantees of the bill of rights. See, e.g., *Connally v. Georgia*, 429 U.S. 245, 250-51, 97 S.Ct. 546, 549 (1977).

As a matter of federal statutory policy, arbitration is now a *favored* method of dispute resolution, especially favored over traditional judicial proceedings. This alternative to litigation has enabled a plethora of small businesses to participate in proffering to American consumers many kinds of goods and services that *originate* with those tiny economic units.[6]

"Mom and Pop" companies and embryonic enterprises can be stifled by legal expenses attendant on the wildfire expansion of suits. It really does not matter whether the asserted claim(s) are viable, or even if summary disposition mechanisms (*see, e.g.*, Fed. R. Civ. Pro. 56) might abort lengthy court proceedings.

The very existence of a pending suit engenders judicial costs, attorneys fees and business disruption that easily can swamp a modestly sized local enterprise. Alan S. Kaplinsky, *The Use of Pre-Dispute Arbitration Agreements by Consumer Financial Service Providers*, 1472 PLI/Corp. 249, 253 (2005). As a matter of sheer survival, these merchants are compelled to settle with aggressive plaintiffs' lawyers, irrespective of any fault of the businesswoman or businessman. *Id.* The perils of finding themselves in that sort of dilemma

[6] A small company that *creates* consumer goods and services is very differently situated from one which sells at retail goods manufactured or distributed by another. In the latter case, the most substantial risk arises from product(s) liability claims, but the law generally allocates ultimate financial responsibility to the entity that created the defect in the product. *Restatement (Third) of Torts; Prod. Liab.*, §1. A defendant retailer can employ various means to transfer liability to the product's distributor, which in turn normally can bring in the product's manufacturer as the ultimately responsible party. *E.g., Fed. R. Civ. P. 14*; *Uniform Apportionment of Tort Responsibility Act*, §1 *et seq.* (2003). The manufacturer is able to insure against the loss by spreading the cost of insurance over all its products made and sold into the distributional pipeline. This system of risk allocation cannot alleviate the dangers to a small business that *itself* creates consumer financial services. Only through enforceable arbitration clauses can a tiny economic entity hope to sustain itself while also affording its customers fair remedies.

can force entrepreneurs to cease conducting transactions in those goods and services. Most perniciously, potential entrants to the market are discouraged from commencing business by the prospect of absorbing the non-productive expenses of threatened consumer litigation.[7]

II. GUTTING THE FEDERAL ARBITRATION ACT IS NOT A PREREQUISITE TO THE VINDICATION OF STATE AUTHORITY TO ENFORCE PUBLIC POLICY.

Lingering apprehensions about the potentially negative impact of arbitration proceedings on the enforcement of *state*

[7] Under established economic doctrine, consumers benefit from reduced business costs, the savings from which are reflected in price and non-price (superior services, convenience etc.) competition. There is no reason that these universal principles would not apply to the savings associated with the use of arbitration as a less expensive dispute resolution mechanism than in courts. See, *e.g.*, Stephen J. Wore, *Paying the Price of Process; Judicial Regulation of Consumer Arbitration Agreements*, J. *Dispute Resol.* 89, 93 (2001). There have been challenges to this proposition on the ground that "perfect competition" rarely exists in the provision of consumer financial products due to economic entry barriers. Jean R. Sternlight and Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practices or Unconscionable Abuse?, 67 SPG Law & Contemp. Probs*. 75, 92-94 (2004). As demonstrated in this brief, there are very few entry barriers confronting new financial service centers and the provision of PDAs to consumers. The PDA marketplace in California is illustrative of vigorous competition. Scores of advertisements for different PDA companies appeared in last year's San Diego, California Yellow Pages. *2004 Yellow Pages, San Diego, California* at 298 to 299; 704 to 708. Some of these advertisements stress non-price competition through speedy transactions (Money Tree-PDAs "in just minutes;" Cashman—"Cash Advance in 5 minutes or less") or extended days and hours of operation (Western Check Cashers—"Open 7 days") Others expressly offer PDAs at prices well below the statutorily authorized 15% rate cap (*e.g.*, Advance Check Services—"50% OFF!" for new customers; All City Financial—"10% Payday Advance"). *Id. See California Deferred Deposit Transaction Law*; Cal. Fin. Code §23000 *et seq.*

substantive public policy are chimeras. These fears cannot be allowed to nullify the *federal public policy* favoring *procedural* recourse to alternative dispute resolution authorized under the FAA. When one clears away analytically all the catch-phrases, such as "void *ab initio*," "voidable" and "inherently unlawful," along with all the window dressing designed to distinguish the indistinguishable doctrine of *Prima Paint*, there remains at best a suspicion that arbitrators somehow might enforce contract provisions in a way that would contravene controlling precepts of state law. But nothing in the FAA precludes a state from exercising the full range of its police powers to remedy wrongs, including those that might arise from a contract that contains an arbitration clause.

In its decision below, the Florida Supreme Court distorted this Court's separability doctrine articulated in *Prima Paint*, *supra*, 388 U.S. at 403-404, 87 S.Ct. at 1806. That doctrine holds that the enforceability of an "agreement to arbitrate" contractual disputes must be determined without reference to the wholly distinct issue of whether the remainder of the contract is itself valid and enforceable. *Id.*

While discussing the very circumscribed judicial role in implementing the FAA, Justice Fortas noted in *Prima Paint* that courts would retain some authority over certain types of defenses to a demand that a party submit to arbitration. *Id.* These "pre-arbitration" defenses, sometimes characterized at common law as "real defenses," were focused on the basic mechanics through which contractual obligations are formed. In the main, these defenses were concerned with whether a party "assented" to the contract, rather than whether the party might have misunderstood the contract's import or relied on extra-contractual representations. *Id.*

"Real defense" challenges to contract formation might include claims:

- of forgery of a party's signature to a written instrument;
- that a party signed a different document whose signature page was appended to some other writing; and
- of an incapacity to contract, as with a minor or a mentally impaired person for whom a guardian has been appointed by a court.

Successfully proving any of these defenses would negate the "existence" of any valid contract, including the agreement to arbitrate disputes lodged within the instrument, but that would mean that the arbitration clause itself was unenforceable because no "agreement to arbitrate" was ever formed.

Prima Paint's holding did not preempt judicial jurisdiction over disputes relating to whether the requisite mechanics of contract formation were satisfied.[8] With the failure of those proofs, it might be said that "no contract was ever formed." This verbalization is echoed in the Florida Supreme Court's decision below. *Cardegna et al. v. Buckeye Check Cashing*, Inc., 894 So. 2d 860, 863 (Fla. Supreme Ct. 2005) ("[T]he underlying contract would be rendered void from the outset if it were determined that the contract . . . violated Florida's usury laws.").

Verbal prestidigitation was employed below to confound the concept of a fatal evidential deficiency in the mechanics of contract formation, in which case "no contract was ever formed," with the substantive public policy issue of whether the content of a contract so taints its terms that it is unen-

[8] Even if the FAA allowed states to resolve these issues in pre-arbitration proceedings, states remain free to permit arbitrators to address those claims. *E.g., Uniform Arbitration Act* (2000).

forceable. Whether a state court mischaracterizes both of these very different situations as being governed under state law by the "void *ab initio*" doctrine cannot affect the applicability of the FAA. As long as the contract's "arbitration agreement" received proper assent, under the forum selection provisions of the FAA it is completely irrelevant how offensive the balance of the contract may be to state law.[9]

The survival of residual judicial hostility to arbitration is almost unfathomable when considered against the actual experience of consumers who participate in alternative dispute resolution. There is no indication at all that consumer claims and/or defenses are not considered fairly by neutral arbitrators who apply the same legal principles as would a court considering the identical issues. Ernst & Young, *Outcomes of Arbitration—An Empirical Study of Consumer Lending Cases*, 2 to 3 (2004). The only difference is that the arbitration award is rendered more quickly and less expensively than generally is attainable through the judicial process.

Meticulous efforts to assure fairness are the hallmarks of contemporary arbitration clauses in consumer contracts. This is understandable because vendors of goods and services who seek to invoke the FAA are aware in the first instance that

[9] A litigant almost would have to be deranged to invoke the FAA to enforce substantive contract terms that flagrantly flaunt public policy. An arbitrator would be expected to act fairly and enforce the public policy. Perhaps even more significantly, the losing party would remain exposed to penalties imposed in administrative hearings and judicial proceedings by state officials charged with enforcing the public policy. Because § 4 of the FAA requires the institution of suit in the appropriate federal district court, the complaint and contract in dispute become public documents readily available to state and local officials as well as the press and the community at large. Rational litigants would shun the invocation of the FAA when it would entail the disclosure of unseemly practices. This "publicity" aspect of the FAA buffers the statute from becoming a device to circumvent state public policy. The practical significance of the "disclosure" requirements of the FAA are discussed at greater length, *infra*.

the FAA's benefits are conditioned on the availability of equitable, litigant-friendly arbitration procedures. *Green Tree Financial Corp.–Alabama et al. v. Randolph*, 531 U.S. 79, 89 to 92, 121 S.Ct. 513, 521-523 (2000).

The advantages of arbitration are only available when the agreement to arbitrate is enforceable. Excessively onerous, one-sided arbitration provisions/procedures may be subject to attack on "unconscionability" grounds derived from general principles of state law. *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practices or Unconscionable Abuse?*, *supra*, 67 *SPG Law & Contemp. Prob.*, *supra* at 77-78. To avoid triggering that nearly universal defense in consumer disputes, it is in the self-interest of the business community to afford consumers inexpensive, easily invokable procedural rights in the arbitration process. Almost any rational merchant would prefer to advance the arbitration fee(s) for a consumer claimant than to incur the financial burdens inherent in engaging even the most reasonably priced attorney's services in judicial proceedings. Informal consumer arbitration procedures do not require representation of a respondent business by lawyers. Managers of businesses can appear in defense of consumer claims being resolved in arbitration. Similarly, the arbitration process does not entail the payment of court filing fees or the costs of serving original process through a sheriff, bailiff or other public officer. Cf. Joseph M. Matthews, *Consumer Arbitration*, 79 APR. Fla. B.J., 22, 24-27 (2005).

Consumer contract arbitration clauses typically invoke application of the rules of a non-profit national institution, which also is designated to administer the arbitration. Among the principal institutions overseeing the arbitration of consumer contract claims are the American Arbitration Association and the National Arbitration Forum ("NAF"). In her separate opinion in *Green Tree Financial Corp.-Alabama et al. v. Randolph, supra* 531 U.S. at 95-96, 121 S. Ct. at 524

to 525, Justice Ginsberg noted with approval the special pro-consumer arbitration rules adopted by the American Arbitration Association. The other institutional arbitration administrators have manifested similar sensitivity in accommodating consumer contract claims. For example, three years ago the NAF promulgated an arbitration "bill of rights" whose initial "principle" stresses the NAF's commitment to a "fundamentally fair process." National Arbitration Forum, *Arbitration Bill of Rights with Commentary* (2002).

Very early in the emergence of the PDA industry, *amicus curiae* Financial Service Centers of America emphasized the requirement that its members providing PDA services are obliged to treat borrowers with fairness in every aspect of a PDA transaction. This duty extends to the remedies and remedial procedures specified in a PDA agreement.

In 1998 FiSCA became the first national trade association to impose on its members a written code of conduct governing PDA transactions. *Financial Service Centers of America, Inc., Code of Conduct* (1998). That code of conduct has been amended periodically and remains in force. (www.fisca.org). Violations of the Code of Conduct by FiSCA members are subject to organizational sanctions, including "expulsion" from FiSCA. *Id.* In an effort to promote the use of equitable and enforceable arbitration agreements in PDA transactions, six years ago FiSCA published a "model arbitration clause" for use by its members. *Id.* FiSCA's model arbitration agreement is modified as necessary to enhance the rights of individual consumers and conform to applicable legal developments. At present, the "model" arbitration provision invokes the consumer friendly procedures of the National Arbitration Forum. *Id.*

That a consumer gets a "fair shake" and even more in an arbitration forum is confirmed by the overwhelming majority of empirical studies on that subject. See, *e.g.*, Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases*, *supra* (February 2005) http://www.arbforum.com/media/EY_2005.pdf); Louis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 Colum. Hum. Rts. L. Rev. 29 (1998). A consumer is more likely to prevail in a consumer credit arbitration than a business. Recent empirical data shows that consumers are more likely than businesses to obtain a favorable outcome, with 55% of arbitrations resolved in favor of the consumer. *Id.* Consumers not only have a positive experience in arbitration, but also are typically satisfied with the arbitration process. According to the *Ernst & Young* study, more than two-thirds of consumers are either satisfied or very satisfied with the arbitration process. *Id.*

Favorable consumer outcomes through arbitration are not unique to consumer lending. For example, in the employment arena, the benefits of arbitration to the individual employee are just as evident. When employment claims are filed in federal court, individual plaintiff employees prevail in just under 15% of the cases against corporations. *Maltby, Private Justice: Employment Arbitration and Civil Rights*, *supra* at 46. In stark contrast, the NAF reports a success rate of 63% when individuals bring employment claims against corporations in arbitration proceedings. *National Arbitration Forum, Bill of Rights with Commentary, supra.* The extent of the relief obtained by individuals in NAF arbitrations exceeds by over one-third the relief awarded in federal court for the same type of claims. *Id.*

State "public policy" is enforced as a matter of course in arbitrations. The institutional administrators of those proceedings require that arbitrators enforce the substantive law and impose remedies in conformance with that law. See, *e.g.*, *National Arbitration Forum, Arbitration Bill of Rights with Commentary*, Principle 12. AWARDS AND REMEDIES (NAF arbitrators must "swear an oath to decide arbitrations under the applicable substantive law")

Finally, arbitrations neither threaten nor impair the vindication of a state's public policy. The result of a decision in a simple dispute between private parties hardly can be said to imperil statewide substantive law. This is true whether the dispute is resolved by a court or by an arbitrator. In this context, the practical "finality" of arbitration awards cannot be considered to detract from the benefits of arbitration. The mere availability of appellate review of a judicial decision cannot guarantee that the judgment conforms strictly to state law. Given the often cramped scope of appellate review, litigants who can afford an appeal still may find themselves saddled with a judgment incompatible with the objective application of state law. These situations merely reflect the marginal impact of idiosyncratic factors. They may include the extent of the experienced or astuteness of a judge, the relative diligence of counsel for the parties in preparing for trial and presenting their respective clients' cases or an imbalance in the extent of resources that can be invested in a trial.

The instant case is a graphic illustration of why enforcement of a state's public policy is impervious to the resolution in arbitration of disputes relating to that public policy. In their initial pleadings, filed with Florida's courts, plaintiffs' principal claim is that the terms of the agreements they entered into are usurious and contrave various Florida statutes, including the proscriptions against "criminal usury" *Fla. Stat. Anno. XXXIX*, §687.071. This statute was the foremost source of that state's "public policy" identified in the Florida Supreme Court's opinion below as potentially posing an insuperable barrier to application of the FAA. *Cardegna et al. v. Buckeye Check Cashing, Inc., supra*, 894 So. 2d at 864 to 865.

As discussed above, an arbitrator can read and digest the plaintiffs' claims and the legal authority(s) underlying those claims. Whatever award the arbitrator makes, Florida's prohibitions against usury will continue in full force and effect.

When it enacted the FAA in 1925, Congress never intended to invade the indubitable plenary police powers of states to enact substantive law controlling contracts' subject matter, terms and remedies. But Congress did intend to promote interstate commerce by creating controlling federal authority to guarantee an alternative dispute mechanism to resolve wholly private claims, irrespective of the subject matter of the disputes.

Florida's paramount mechanisms for proscribing the practice of usury have nothing whatsoever to do with enforcement of the FAA as it was construed in *Prima Paint*. Rather, by statute the Florida Legislature has conferred on executive branch officials the responsibility for preventing usury and affording relief to its victims. "Criminal usury, loan sharking" and "shy-locking" are expressly proscribed by *FLA. Stat. Anno. XXXIX*, §687.071. Violations are second degree misdemeanors when the annual interest rate exceeds 25% and is less than 45%. *Fla. Stat Anno. XXXIX*, §687.071 (2). If the annual interest rate exceeds 45%, criminal usury is an indictable crime of the third degree *Fla. Stat. Anno. XXXIX*, §687.071(3). Prosecutions for violations of §687.071(3) can be instituted by any of the state attorneys in Florida's 67 counties or by the Florida Attorney General. Express self-executing grants of transactional and use immunity are provided by statute to further both judicial and investigative proceedings, including for "any violation" of §687.071. Because this statute makes unenforceable, in Florida's courts, the collection of a usurious debt, it appears that these extraordinarily broad immunity provisions are applicable generally in civil "proceedings", including in FAA arbitrations. *Fla. Stat. Anno. XXXIX*, §687.071 (6) and (7).

Florida's RICO law establishes another instrumentality for enforcing that state's proscriptions against criminal usury. The "collection of an unlawful debt" comprises one of the specifically defined forms of conduct encompassed by the

state RICO statute and indictable criminal usury constitutes a "predicate crime" under the definition of "racketeering activity." *Fla. Stat. Anno. XLVI*, §895.02(1)(a)(19); *Fla. Stat. Anno. XLVI*, §895.03(1).

In this case the administrative authority conferred on Florida's banking authorities was also available to remedy any possible unlawful practices of appellant Buckeye Check Cashing, Inc. That company is a check casher "registered" under Florida law. *Fla. Stat. Anno. XXXIII*, §560.301 *et seq.* (Florida's "Check Cashing and Foreign Currency Exchange Act"). At the time the transactions at issue were conducted, they proceeded under a statutorily established fee protocol accepted by the state banking authorities responsible for implementing and enforcing compliance with the licensing statute and regulations. *Fla. Stat. Anno. XXXIII*, §560.309. Transactions under that protocol were conducted openly throughout the state with the full knowledge of state officials. If Florida's "public policy" was being flouted, the officers primarily responsible for enforcing that public policy did not perceive any violations.[10]

Plaintiffs' claims stem from their disagreement with the responsible state public officials on how to construe the pertinent provisions of Florida's laws. That disagreement was, and is, a matter plaintiffs should have addressed, and may still address, in the available legislative and administrative arenas. The key point is that Florida's public policy against usury can be vindicted in many different ways by many different officials. Enforcement of the FAA's benign forum selection provisions in this case is completely unrelated to preserving the integrity of whatever Florida public

[10] Since the dates of the transactions at issue in this matter, Florida has authorized PDA's under a licensing statute that provides for essentially the same fees as were charged under the prior protocol by licensed check cashers. Compare *Fla. Stat. Anno. XXXIII*, §560.309 with *Fla. Stat. Anno. XXXIII*, §560.404.

policy may be resolved in the subsequent substantive phase of the arbitration proceeding to which the parties agreed.

CONCLUSION

For the reasons stated above, *amici curiae* respectfully urge that this Court reverse the judgment entered below by the Supreme Court of Florida and remand this matter with directions that respondents' claims be referred for resolution in arbitration in accordance with the Federal Arbitration Act.

Respectfully submitted,

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Supreme Court, U.S.
FILED
SEP 23 2005
OFFICE OF THE CLERK

No. 04-1264

In The
Supreme Court of the United States
October Term, 2005

BUCKEYE CHECK CASHING, INC.,
Petitioner,
v.

JOHN CARDEGNA, et al.,
Respondents.

On Petition For Writ of Certiorari To the Florida Supreme Court

BRIEF OF FLORIDA, ALASKA, ARIZONA, ARKANSAS, CALIFORNIA, COLORADO, CONNECTICUT, DELAWARE, DISTRICT OF COLUMBIA, GEORGIA, HAWAII, IDAHO, ILLINOIS, INDIANA, IOWA, KENTUCKY, MAINE, MARYLAND, MASSACHUSETTS, MINNESOTA, MISSISSIPPI, MISSOURI, MONTANA, NEVADA, NEW HAMPSHIRE, NEW MEXICO, NEW YORK, NORTH CAROLINA, NORTH DAKOTA, OHIO, OREGON, PENNSYLVANIA, PUERTO RICO, RHODE ISLAND, SOUTH DAKOTA, TENNESSEE, TEXAS, UTAH, WASHINGTON, WEST VIRGINIA, WISCONSIN, AND WYOMING AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED (RESTATED)

Whether the Federal Arbitration Act compels a State to enforce an arbitration clause embedded in an agreement that is criminally illegal under the laws of the State in which it was entered, in direct contravention of that State's established public policy.

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INTEREST OF *AMICI CURIAE*

The States have a compelling interest in protecting the system of dual sovereignty created by the Constitution. To preserve the federalist system, the States must retain their identity as separate sources of governmental power and remain free to adopt consumer protection laws. To that end, the States' legitimate public policy determinations that certain illegal agreements are void as to all terms must be respected.

The Federal Arbitration Act ("FAA"), as interpreted by this Court in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and by the circuit courts that have addressed the issue in purportedly following *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), has dramatically eroded the States' sovereign power. The Court in *Southland* transformed the FAA from a procedural statute applicable only in federal courts into a "Federal bludgeon to force . . . individual State[s] into . . . unwilling submission to arbitration enforcement." *See Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong. 40 (1924) (testimony of Julius Cohen, principal drafter of the FAA, *assuring Congress that the FAA would not do this*). The circuit courts, in purportedly following *Prima Paint*, have abandoned even the pretext of federalism and eliminated the States' ability to have their courts declare certain contracts illegal.

In this brief, forty States, through their Attorneys General, ask this Court to (1) overturn *Southland*, which has been recognized, almost universally, as wrongly decided, and (2) respect principles of federalism by halting the expansion of *Prima Paint*.

SUMMARY OF THE ARGUMENT

A majority of Justices of this Court have recognized, along with virtually every legal scholar that has written on the subject, that Congress never intended for the FAA to apply in state court proceedings. Congress intended the FAA to be nothing more than a procedural statute designed to reverse the common law antipathy for arbitration agreements as it existed in early twentieth century federal courts. Because the Congress that enacted the FAA did not intend for it to have preemptive effect, *Southland* is clearly wrong.

This Court has held repeatedly that when Congress seeks to preempt state law in a field traditionally occupied by the States, it must evince an intention to do so in unmistakably clear language. Not only is the FAA itself devoid of any clear preemptive language, but the legislative history preceding enactment of the FAA indicates the opposite—that Congress never suspected the FAA would apply in state courts or preempt arguably inconsistent state law.

Nothing in the FAA supports the notion that Congress intended to dictate to States when and how they can make their courts available to hear state law contract disputes. Assuming Congress relied on its commerce power when it enacted the FAA and intended to create substantive federal rights, the commerce power merely authorizes Congress to regulate interstate commerce directly—it does not authorize Congress to regulate state governments' regulation of interstate commerce. Accordingly, to the extent *Southland* holds to the contrary, it should be overruled.

Stare decisis is an inadequate justification for retaining *Southland* due to the injury it causes the States. *Southland* forces the States to rigorously enforce arbitration clauses, and precludes

the States from carving out limited public policy exceptions to the ambiguous "national policy favoring arbitration."

Even if *Southland* is retained notwithstanding the overwhelming evidence of its shortcomings, the decision of the Florida Supreme Court should be affirmed because nothing in *Southland* or *Prima Paint* precludes the States from refusing to enforce arbitration clauses embedded in criminally illegal agreements. States are free to regulate arbitration clauses under general contract law principles, and States may invalidate arbitration clauses "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The "making of [an] agreement for arbitration" is clearly at issue when it is embedded in a criminally illegal agreement. Nothing in the FAA, *Southland*, or *Prima Paint* was intended to undermine the States' sovereign right to nullify criminally illegal contracts *in toto*. States have a compelling interest in protecting their citizens from predatory lending and other unscrupulous business practices. The freedom of contract principles that govern most private agreements must yield to countervailing state public welfare laws, at least to the extent those laws do not discriminate against arbitration.

Finally, the source of the *Prima Paint* separability rule, the "making of the agreement for arbitration" language in section 4, was only intended to apply in federal court proceedings. This Court should not use the theory of "section 2" preemption announced in *Southland* to bootstrap the procedural provisions of the FAA in contravention of their plain and unambiguous meaning.

ARGUMENT

I. *Southland* should be overruled.

a. *Southland* is irreconcilable with the otherwise well-settled "clear statement" rule.

The Constitution creates a system of dual sovereignty in which the States retain substantial sovereign authority. *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991). While the Supremacy Clause, U.S. Const., art. VI, cl. 2, permits Congress to impose its will on the States when acting pursuant to its enumerated powers, this Court has described this as "an extraordinary power in a federalist system" that "[the Court] must assume Congress does not exercise lightly." *Id.* at 460. In light of the respect for state sovereignty implicit in the structure of the Constitution, this Court has repeatedly followed the rule of statutory construction that "if Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention to do so unmistakably clear in the language of the statute." *Id.* at 460 (citing *Atascadero State Hospital v. Scanlon*, 473 U.S. 234, 242 (1985)), *quoted in Will v. Michigan Dep't of State Police*, 491 U.S. 58, 65 (1989); *see Raygor v. Regents of the Univ. of Minn.*, 534 U.S. 533, 543 (2002) (quoting *Will*); *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765, 787 (2000) (same); *see also Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

Southland is a conspicuous exception to this otherwise well-settled "clear statement" rule. The *Southland* majority candidly described the legislative history surrounding the FAA as "not without ambiguities." *Southland*, 465 U.S. at 12; *compare, e.g., Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 146-147 (1963) ("We are not to conclude that Congress legislated the ouster of this [state] statute . . . in the absence of an unambiguous congressional mandate to that effect."). In dissent, Justice O'Connor, joined by then-Justice Rehnquist, concluded

that the legislative history was unambiguous and "establish[d] conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only in federal courts." *Southland*, 465 U.S. at 25 (O'Connor, J., dissenting).

At varying times, seven of the eight Justices sitting on this Court, along with former Chief Justice Rehnquist, have written or joined in opinions recognizing that "FAA preemption" is, in the words of Justice O'Connor, "unfaithful to congressional intent," *id.* at 36, and thus based only loosely on the actual FAA. Justice Stevens, joined by Justices Ginsburg, Breyer, and Souter, wrote in dissent in *Circuit City Stores v. Adams*, 532 U.S. 105 (2001), that "the Court's interpretation of the [FAA] has given it a scope far beyond the expectations of the Congress that enacted it." *Id.* at 132 (Stevens, J., dissenting). As Justice Stevens recognized in his dissent in *Perry v. Thomas*, 482 U.S. 483 (1987), "[i]t [was] only in the last few years that the Court ha[d] effectively rewritten the [FAA] to give it a pre-emptive scope that Congress certainly did not intend." *Id.* at 493 (Stevens, J., dissenting). Justice Thomas, joined by Justice Scalia, dissented in *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 263 (1995), principally on the bases identified by Justice O'Connor in her dissent from *Southland*. *Id.* at 285-93 (Thomas, J., dissenting); *see also id.* at 284 (Scalia, J., dissenting) ("I agree with the respondents (and belatedly with Justice O'Connor) that *Southland* clearly misconstrued the Federal Arbitration Act."). These opinions make clear that the *Southland* majority itself, along with, at varying times, at least seven of the eight Justices of the present Court, did not believe that anything in the FAA makes "unmistakably clear" that Congress intended to apply the FAA to the States.[1]

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[1] David S. Schwartz, *Mandatory Arbitration: Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 Law & Contemp. Prob. 5, 6 (2004) ([I]t may be that no Justice on th[is] Court believes *Southland* was correctly decided . . . ").

The premise of *Southland* is that the FAA was an exercise of Congress's power to enact substantive federal law under the Commerce Clause. *Southland*, 465 U.S. at 11-12. Relying on Justice Black's dissent in *Prima Paint*, the Court observed that when Congress creates substantive rules of federal law pursuant to its commerce power, "it normally creates rules that are enforceable in state as well as federal courts." *Id.* at 12 (citing *Prima Paint*, 388 U.S. at 420 (Black, J., dissenting)). The two principal problems with this premise are (1) Congress never intended the FAA to create substantive rules of federal law; and (2) Congress did not rely on its commerce power, at least not principally, when it enacted the FAA.

As Justice O'Connor observed in her *Southland* dissent, "[o]ne rarely finds a legislative history as unambiguous as the FAA's. That history establishes conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only to federal courts, derived, Congress believed, largely from the federal power to control the jurisdiction of the federal courts." *Southland*, 465 U.S. at 25 (O'Connor, J., dissenting). The consensus, near universal view of scholarly commentary is that Justice O'Connor was right.[2] *Cf. Camps*

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[2] *See, e.g.*, Scott J. Burnham, *The War Against Arbitration in Montana*, 66 Mont. L. Rev. 139, 200 (2005) ("Let's start with the widely shared premise that the U.S. Supreme Court took a wrong turn in *Southland v. Keating*. It should never have held that the Federal Arbitration Act is applicable to the states."); Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 Fla. L. Rev. 175, 192 (2002) ("[T]he Court [in *Southland*] chose to remake jurisdictional history, transporting the jurisdictionally cautious 1925 statute into the rich post-New Deal jurisdictional environment. . . . In remaking history, the Court had made law. Nowhere is the declaration of a 'national' policy-as opposed to the 'federal' policy discerned a year earlier in *Moses Cone* to be found in the text of the statute, its legislative history, or the contemporary apologia of the Act's sponsors.") (footnotes omitted); Nancy R. Kornegay, Comment, *Prima Paint to First Options: The Supreme Court's Procrustean Approach to the Federal Arbitration Act and Fraud*, 38 Hous. L. Rev. 335, 338 (2001) (arguing that overruling *Southland* "will correct [the Court's] course to once again be in

Newfound/Owatonna v. Town of Harrison, 520 U.S. 564, 591 (1997) (recognizing relevance of scholarly commentary in declining to depart from subsidy/credit distinction in dormant Commerce Clause jurisprudence). According to Professor David S. Schwartz, who was counsel of record for the twenty-five law professors that urged the Court to overrule *Southland* as *amici curiae* in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003),[3] "[t]he historical record clearly shows that the FAA was intended to be a procedural statute for the federal courts, that it was not intended to preempt state law, and that it was designed to reverse the [common law theory that arbitration was an 'ouster

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harmony with both the original legislative intent of the FAA and the traditional doctrine of federalism that has allowed states to adjudicate contracts within their own boundaries"); Ian R. Macneil, Federal Arbitration Law § 10.5.3 (1994) (referring to the "pillar" of legislative history supporting *Southland* as "truly a pillar of sand"); Larry J. Pittman, *The Federal Arbitration Act: The Supreme Court's Erroneous Statutory Interpretation, Stare Decisis, and a Proposal for Change*, 53 Ala. L. Rev. 789, 863-74 (2002) (urging the Court to reexamine *Southland* due to the paucity of sources supporting the majority decision and the wealth of sources supporting Justice O'Connor's dissent); Schwartz, *supra*, note 1, at 5 (2004) ("[*Southland*] transformed a quaint, sixty-year-old procedural statute into a permanent, unauthorized eviction of state-court power to adjudicate a potentially large class of disputes, as well as an eviction of state lawmaking power over the traditional state domain of contract law.") (footnote and internal quotation omitted); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L. Q. 637, 701 (1996) ("It is time for the Supreme Court to reassess its extreme preference for mandatory binding arbitration over litigation, and to replace its current preference with the more limited acceptance of binding arbitration initially intended by Congress when it enacted the FAA."); Jack Wilson, *"No-Class-Action Arbitration Clauses," State-Law Unconscionability, and the Federal Arbitration Act: A Case for Federal Judicial Restraint and Congressional Action*, 23 Quinnipiac L. Rev. 737, 747 (2004) (commenting that *Southland* "should be taken as a given" because of the Court's reticence in the face of constant criticism, and thus "there is little to gain by extensively rehashing the FAA's legislative history to once again show that the *Southland* majority was wrong and Justice O'Connor's *Southland* dissent was right").

[3] Brief of Law Professors as Amici Curiae in Support of Respondents, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (No. 02-634).

of jurisdiction'] but otherwise preserve all applicable state contract law." Schwartz, *supra* note 1, at 8 (footnote omitted). "The idea that the FAA would apply in state courts or preempt state law was beyond the contemplation of Congress; it simply did not arise in the legislative history of the Act." *Id.* at 18. According to Professor Ian Macneil, author of the leading scholarly account of the FAA's legislative history,[4] that history is the only "pillar supporting *Southland*," and "[i]t is truly a pillar of sand." Macneil, *supra* note 2, § 10.5.3.

The legislative history is replete with examples of the nonsubstantive nature of the FAA. The House Report accompanying the act stated:

> Whether an agreement for arbitration shall be enforced or not *is a question of procedure* to be determined by the law court[5] in which the proceeding is brought *and not one of substantive law* to be determined by the law of the forum in which the contract is made. Before such contracts could be enforced in the Federal Courts, therefore, this law is essential. *The bill declares that such agreements shall be recognized by the courts of the United States.*

H.R. Rep. No. 68-96, at 1 (1924) (emphasis added). After describing the need for the law, the report reiterates: "The bill declares simply that such agreements for arbitration shall be enforced, *and provides a procedure in the Federal Courts for their enforcement.*" *Id.*, at 2 (emphasis added).

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[4] Ian R. Macneil, American Arbitration Law 92-121 (1992); *see id.* at 106 ("[A]ny idea that section 2 is somehow independent of the remaining sections, that it creates its own system of independent regulation separate from the remaining sections is a historical absurdity."). Only a handful of examples from this extensive legislative history are included in this brief.

[5] The report's reference to "law court" was probably a typographical error intended to read "law of the court." Schwartz, *supra* note 1, note 90.

The report also acknowledges that the bill was drafted and sponsored by a committee of the American Bar Association (the "ABA"), *id.*, at 1, and an article by that ABA committee, published in the ABA Journal contemporaneously with the FAA, made the point even more explicitly:

> A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the Federal courts. It is no infringement upon the right of each State to decide for itself what contracts shall or shall not exist under its laws. To be sure whether or not a contract exists is a question of the substantive law of the jurisdiction wherein the contract was made. But whether or not an arbitration agreement is to be enforced is a question of the law of procedure and is determined by the law of the jurisdiction wherein the remedy is sought.

W.H.H. Piatt, et al., *The United States Arbitration Law and Its Application*, 11 A.B.A.J. 153, 154-55 (1925); *accord* Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 275-76 (1926).

Moreover, Congress's authority to enact the FAA, according to its drafters, did not rest solely on Congress's commerce and admiralty powers:

> The statute establishes a procedure in the Federal courts for the enforcement of arbitration agreements. It rests upon the constitutional provision by which Congress is authorized to establish and control inferior Federal courts.

Id. at 154; Cohen & Dayton, *supra*, at 275.

Julius Cohen, a principal drafter of the act, explained in a 1926 law review article that "[t]he primary purpose of the statute is to make enforceable in the Federal courts such agreements for

arbitration, and for this purpose Congress rests solely upon its power to prescribe the jurisdiction and duties of the Federal Courts." Cohen & Dayton, *supra*, at 277-78. Cohen made this same point in his testimony before the House and Senate, explaining to Congress that the act was "[an] exercise of your power to confer jurisdiction on the Federal courts." *Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong. 17 (1924) ("Joint Hearings"), *quoted in Prima Paint*, 388 U.S. at 420 n.21 (Black, J., dissenting). Cohen explained to Congress: "The theory on which you do this is that you have the right to tell the Federal courts how to proceed," *Id.*

Cohen also testified that the act had no federalism implications, assuring Congress that

> it [cannot] be said that the Congress of the United States, *directing its own courts . . .* , would infringe upon the provinces or prerogatives of the States. . . . The question of the enforcement relates to the law of remedies and not to substantive law. The rule must be changed for the jurisdiction in which the agreement is sought to be enforced . . . . *There is no disposition therefore by means of the Federal bludgeon to force an individual State into an unwilling submission to arbitration enforcement.*

Id., at 39-40 (emphasis added), *quoted in Prima Paint*, 388 U.S. at 420 n.23 (Black, J., dissenting).

The absence of congressional acknowledgment of its supposed intent to preempt state law is also telling. *See* Schwartz, *supra* note 1, at 23-26 (describing how Congress explicitly recognized preemptive effect of contemporary legislation, and discussing the unlikelihood that Congress intended to overrule *sub silentio Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109 (1924)). The Senate Report recognizes that

the arbitration bill "follow[ed] the lines" of New York's arbitration statute that had been "sustained by the decision of the Supreme Court of the United States in the matter of the *Red Cross Line v. Atlantic Fruit Co.*" S. Rep. No. 68-536, at 3 (1924). *Red Cross Line*, which had been decided earlier that year, held that the New York arbitration law was a procedural statute, and thus that New York State courts could apply the act in admiralty cases. *Red Cross Line*, 264 U.S. at 124 ("The Arbitration Law deals merely with the remedy in the state courts in respect of obligations voluntarily and lawfully incurred. It does not attempt either to modify the substantive maritime law or to deal with the remedy in courts of admiralty."). While acknowledging, favorably, the New York statute and *Red Cross Line*, the Senate report conspicuously fails to mention "that the New York law would be preempted, that *Red Cross Line* would become a nullity, or that the Senate disagreed with the Court's conclusion that arbitration is a matter of remedy and not substantive law – let alone that Congress might be overruling *Red Cross Line*." Schwartz, *supra* note 1, at 25.

The FAA's legislative history demonstrates conclusively that the act was never intended to have any application in state court proceedings,[6] and it certainly was never intended to

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[6] Petitioner represents "this case . . . calls for this Court to vindicate federal arbitration rights against the very hostility that motivated the FAA in the first place." Brief For Petitioner, at 2; *see id.*, at 17 ("[T]he Florida Supreme Court's . . . approach reflects the very hostility to arbitration that the FAA was adopted to counteract."); *see also* Brief of Financial Service Centers of America, Inc., et al. as *Amici Curiae* in Support of Petitioner, at 9 (chalking up the Florida Supreme Court's decision to "residual antipathy to arbitration"). In light of the clear and unambiguous legislative history, Petitioner's allusion to Congress's original intent is manifestly and demonstrably erroneous. What this Court is really called on to do in this case is to cabin its own "national policy favoring arbitration," which has supplanted the FAA. Contrary to Petitioner's representations, "Florida public policy favor[s] resolving disputes through arbitration when the parties have agreed to do so." *Orkin Exterminating Co. v. Petsch*, 872 So. 2d 259, 263 (Fla. 2d DCA 2004), *rev. denied*, 884 So. 2d 23 (Fla. 2004); *accord, e.g.*, *KFC Nat'l*

supplant state substantive law. *See, e.g.*, Schwartz, *supra* note 1, at 8 ("If original congressional intent is the touchstone of a statute's preemptive effect, *Southland* was plainly wrong."). Yet the FAA's legislative history, and the Court's prior constructions of that history, were the only bases on which *Southland* was decided. According to Chief Justice Burger, "[t]o confine the scope of the Act to arbitrations sought to be enforced in federal courts would frustrate what we believe Congress intended to be a broad enactment appropriate in scope to meet the large problems Congress was addressing." *Southland*, 465 U.S. at 14. The dearth of any evidence of congressional intent to displace state law demonstrates clearly that *Southland* has nothing to do with "the FAA," unless "the FAA" has nothing to do with original congressional intent.

Accordingly, it was this Court in *Southland*, and not anything remotely attributable to Congress, that "withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *See Southland*, 465 U.S. at 10. Because the question of whether state action is preempted by a federal statute necessarily depends on congressional intent, *see, e.g.*, *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 137-38 (1990), *Southland* was not only wrong when it was decided—it cannot be sustained under any other rationale.

b. Congress never intended for the FAA to conscript state judicial proceedings.

The construction of the FAA adopted by this Court in *Southland* constitutes "a permanent . . . eviction of state-court power to adjudicate a potentially large class of disputes." *Allied-*

Mgmt. Co. v. Beauregard, 739 So. 2d 630, 631 (Fla. 5th DCA 1999). In fact, Florida has enacted a comprehensive arbitration code, which, mirroring section 2 of the FAA, declares most arbitration agreements "shall be valid, enforceable, and irrevocable without regard to the justiciable character of the controversy." § 682.02, Fla. Stat. Virtually every other state has enacted similar legislation. *See infra* note 12.

Bruce, 513 U.S. at 284-85 (Scalia, J., dissenting). If *Southland* is correct, the 1925 Congress issued a general directive to state courts, compelling them to invariably enforce arbitration provisions embedded in commercial contracts without regard to countervailing state policy concerns. But there is no basis to conclude Congress intended to conscript state judicial systems in this manner.

Nothing in the Constitution grants Congress the power to control state court dockets or, more specifically, to force state courts to compel arbitration in cases that arise exclusively under state law. To the contrary, "[t]he general rule bottomed deeply in belief in the importance of state control of state judicial procedure, is that federal law takes the state courts as it finds them." *Howlett v. Rose*, 496 U.S. 356, 372 (1990) (internal quotations omitted) (citing *Southland*, 465 U.S. at 33 (O'Connor, J., dissenting)), *quoted in Johnson v. Fankell*, 520 U.S. 911, 919 (1997) (quoting *Howlett v. Rose*, 496 U.S. 356, 372 (1990)) (internal quotation omitted). "The States thus have great latitude to establish the structure and jurisdiction of their own courts." *Johnson*, 520 U.S. at 919 (quoting *Howlett*, 496 U.S. at 372). Further, "the procedure by which rights may be enforced and wrongs remedied is peculiarly a subject of state regulation and control." *Hardware Dealers Mut. Fire Ins. Co. v. Glidden Co.*, 284 U.S. 151, 158 (1931) (holding that Minnesota statute requiring arbitration of fire insurance disputes did not violate due process); *see also Bronson v. Kinzie*, 42 U.S. 311, 315 (1843) ("[A] state may regulate at pleasure the modes of proceeding in its courts in relation to past contracts as well as future. . . . ").[7]

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[7] This court has, of course, held that state courts must hear claims raising questions of substantive federal law by virtue of the Supremacy Clause. U.S. Const., art. VI, cl. 2; *see Testa v. Katt*, 330 U.S. 386, 389 (1947). However, "[a] congressional directive to change a state court procedure is not simply a command to apply existing state judicial resources to enforce a federal right, but a directive to state courts to regulate persons in the state – litigants – in a particular way." David S. Schwartz, *The Federal Arbitration Act and the*

Congress has not federalized commercial obligations, or even arbitration provisions within commercial obligations. Arbitration provisions remain creatures of state contract law, subject to the principles governing all contracts within the relevant jurisdiction. *Allied-Bruce*, 513 U.S. at 281 ("States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.'").

Moreover, as the *Southland* majority recognized, Congress did not create a federal forum for violations of arbitration provisions. *Southland*, 465 U.S. at 16 n.9 ("[Section two of the FAA] does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 or otherwise."); *see also Allied-Bruce*, 513 U.S. at 291 (Thomas, J., dissenting) ("[I]f § 2 really was understood to 'create federal substantive law requiring the parties to honor arbitration agreements,' then the breach of an arbitration agreement covered by § 2 would give rise to a federal question within the subject-matter jurisdiction of the federal district courts.") (citation omitted).

"The Commerce Clause . . . authorizes Congress to regulate interstate commerce directly; it does not authorize Congress to regulate state governments' regulation of interstate commerce." *New York*, 505 U.S. at 166, *quoted in Printz*, 521 U.S. at 924; *see* Schwartz, *supra* note 7, at 542, 620 ("FAA preemption is nothing more or less than procedural regulation of state courts, and . . . Congress lacks the power to regulate procedures in state courts. . . . . [R]elying on the commerce power does not justify the unconstitutional assertion of power to commandeer state courts by dictating procedures to them."). Congress could therefore never have intended this result. To the extent *Southland* holds otherwise, it is incorrect.

Power of Congress over State Courts, 83 Ore. L. Rev. 541, 581 (2004).

c. *Stare decisis* is not a sufficient justification for retaining *Southland* in light of its dramatic impact on State sovereignty.

The doctrine of *stare decisis*, although essential to the stability of the law as a general matter, "is not . . . an inexorable command." *Lawrence v. Texas*, 539 U.S. 558, 577 (2003); *see also, e.g.*, *State Oil Co. v. Khan*, 522 U.S. 3, 20-21 (1997); *Agostini v. Felton*, 521 U.S. 203, 236-37 (1997); *Seminole Tribe v. Florida*, 517 U.S. 44, 63 (1996); *Payne v. Tennessee*, 501 U.S. 808, 828 (1991). "When governing decisions are unworkable or are badly reasoned, this Court has never felt constrained to follow precedent." *Payne*, 501 U.S. at 827 (internal quotation omitted), *quoted in Seminole Tribe*, 517 U.S. at 63.

As explained above, *Southland* is as badly reasoned as it is irreconcilable with the otherwise consistent line of cases that establish the level of respect that must be accorded to the States as sovereigns when the Court considers the preemptive scope of a federal statute. Moreover, the policy underpinning *stare decisis* should be at its weakest when the wrongly decided case results in a dramatic erosion of State power.

The injury to State sovereignty attributable to *Southland* cannot be overstated, as this case aptly demonstrates. Petitioner seeks to compel the Florida courts to enforce a provision in an agreement that is facially criminal under Florida law. This dramatic affront to state sovereignty will have devastating affects on the States' ability to protect their citizens from predatory lending and other unscrupulous business practices. Moreover, the injury to the States is in no way lessened by the legal fiction that the arbitration provision, although inarguably embedded in the criminal agreement, is separable as a matter of federal law. Rather, if adopted by this Court, it will only highlight how powerless the States are to preclude enforcement of criminally illegal agreements.

Respondents' Complaint alleges that Petitioners were in the business of making consumer loans under the guise of a "check cashing" scheme, Joint Appx., at 14-17, and that the annual percentage rate ("APR") of interest charged for these loans ranged from 126% to 1317%, *id.*, at 16, 17. If the allegations of the Complaint are true, Petitioners are "loan sharks", as defined in section 687.071(1)(f), Florida Statutes, and are guilty of systematic felonious conduct, as defined in section 687.071(3).[8]

The Florida Supreme Court declared, as a matter of State public policy, that "there are no severable, or salvageable, parts of a contract found illegal and void under Florida law." *Cardegna*, 894 So. 2d at 864. According to the court, arbitration clauses could not be treated any differently from any other provision out of fear that it would "breath[e] life into a potentially illegal contract." *Id.*; *see also Party Yards, Inc. v. Templeton*, 751 So. 2d 121, 123 (Fla. 5th DCA 2000) ("A court's failure to first determine whether the contract violates Florida's usury laws could breathe life into a contract that not only violates state law, but also is criminal in nature, by use of an arbitration provision."), *quoted in Cardegna*, 894 So. 2d at 862.

The very act of compelling arbitration (or rather, compelling the State of Florida's courts to compel arbitration) is a direct affront to Florida public policy in any agreement that is potentially criminal. Moreover, assuming Petitioner is correct that *Prima Paint*, as applied to the States in *Southland*, dictates that arbitration provisions embedded in potentially criminal agreements are separable as a matter of federal law, it is almost

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[8] Section 687.071(3) provides, in relevant part: "Unless otherwise specifically allowed by law, any person making an extension of credit to any person, who shall willfully and knowingly charge, take or receive interest thereon at a rate exceeding 45 percent per annum or the equivalent rate for a longer or shorter period of time, whether directly or indirectly or conspire so to do, shall be guilty of a felony of the third degree . . . ."

inevitable that the substantively criminal provisions of criminal agreements will at least occasionally be enforced.

Arbitrators are not bound by comparable rules of evidence and discovery. More importantly, arbitrators have no obligation to engage in comparable fact finding, to give detailed reasons justifying their awards, or to assemble a record susceptible to meaningful appellate review. *See, e.g.*, *Wilko v. Swan*, 346 U.S. 427, 436 (1953), *overruled on other grounds*, *Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *El Dorado Sch. Dist. #15 v. Continental Cas. Co.*, 247 F.3d 843, 848 (8th Cir. 2001); *Geneva Sec., Inc. v. Johnson*, 138 F.3d 688, 692 (7th Cir. 1998); *MCI Telecomms. Corp. v. Matrix Communs. Corp.*, 135 F.3d 27, 36 (1st Cir. 1998); *O.R. Sec., Inc. v. Professional Planning Assocs., Inc.*, 857 F.2d 742, 747 (11th Cir. 1988).

Even in cases where a meaningful record has been created, appellate courts are generally precluded from correcting errors in arbitration proceedings. "Factual error" and "legal error" are not grounds for vacatur enumerated in 9 U.S.C. § 10. Accordingly, "even where such error is painfully clear, courts are not authorized to reconsider the merits of arbitration awards." *Bull HN Info. Sys. v. Hutson*, 229 F.3d 321, 330 (1st Cir. 2000) (internal citations and quotations omitted). "As long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision." *Federated Dep't Stores v. J.V.B. Indus.*, 894 F.2d 862, 866 (6th Cir. 1990); *accord, e.g.*, *Gingiss Int'l v. Bormet*, 58 F.3d 328, 333 (7th Cir. 1995) ("Factual or legal errors by arbitrators—even clear or gross errors—do not authorize courts to annul awards.") (internal quotation omitted). Petitioner and his *amici curiae* thus cannot credibly dispute that the "streamlined" fact finding, minimal record, and lack of meaningful appellate review in most arbitration proceedings

dramatically increases the likelihood that cases will be wrongly decided.

The injury to the State is in no way lessened by Petitioner's argument that Respondents voluntarily agreed to arbitrate by assenting to the agreements in question. The State must be able to create limited classes of contracts that are so offensive to public policy that they have no legal effect regardless of assent. With respect to statutes prohibiting usury, the Florida Supreme Court has declared that their purpose is "to bind the power of creditors over necessitous debtors and prevent them from extorting harsh and undue terms in the making of loans." *Chandler v. Kendrick*, 146 So. 551, 552 (Fla. 1933), *quoted in Jersey Palm-Gross v. Paper*, 658 So. 2d 531, 534 (Fla. 1995). Florida public policy is directly contravened if creditors could defeat the purpose of these statutes merely on the basis of procuring assent from "necessitous borrowers" by utilizing an advantageous bargaining position to deprive borrowers of a state court remedy due to "harsh and undue terms" embedded in the agreements they drafted.[9]

Moreover, the broad "national policy favoring arbitration" that the *Southland* majority (erroneously) concluded

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[9] Further, as Justice Black recognized in his *Prima Paint* dissent, the legislative history is crystal clear that the Congress that enacted the FAA never intended that it apply to contracts of adhesion. According to Justice Black, Senator Walsh of Montana expressed reservations,

> cit[ing] insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers or employees. He noted that such contracts "are really not voluntarily [sic] things at all" because "there is nothing for the man to do except to sign it; and then he surrenders his right to have his case tried by the court. . . ." He was emphatically assured by the supporters of the bill that it was not their intention to cover such cases.

Prima Paint, 388 U.S. at 414 (Black, J., dissenting) (footnotes omitted).

was "[declared by Congress] in enacting § 2 of the federal Act," *Southland*, 465 U.S. at 12, applies more broadly to the States than it does to the Federal Government. Congress is free to impose limitations on this "national policy" and exempt certain classes of contracts from the FAA in spite of it. *See, e.g.*, *Shearson/American Express v. McMahon*, 482 U.S. 220, 226 (1987) ("Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command."). As this Court has repeatedly made clear, the States are denied this privilege, *Doctor's Assocs. v. Casarotto*, 517 U.S. 681 (1996); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995); *Perry v. Thomas*, 482 U.S. 483 (1987); *Southland Corp. v. Keating*, 465 U.S. 1 (1984), even though virtually every State has enacted a statute that, like the FAA, renders arbitration agreements generally enforceable as a matter of State law.[10]

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[10]*See* §§ 682.01 to -.22, Fla. Stat.; *see also* Alaska Stat. §§ 09.43.10 to -.480; Ariz. Rev. Stat. Ann. §§ 12-1501 to -1518; Ark. Code Ann. §§ 16-108-201 to -224; Cal. Civ. Proc. Code §§ 1280 to 1294.2; Colo. Rev. Stat. §§ 13-22-201 to -223; Conn. Gen. Stat. §§ 52-408 to -424; Del Code Ann. tit. 10, §§ 5701 to 5725; O.C.G.A. §§ 9-9-1 to -18; Haw. Rev. Stat. §§ 658A-1 to -29; Idaho Code Ann. §§ 7-901 to -922; 710 Ill. Comp. Stat. 5/1 to -23; Ind. Code. Ann. §§ 34-57-2-1 to -22; Iowa Code Ann. §§ 679A.1 to -.19; Kan. Stat. Ann. 5-401 to -422; Ky. Rev. Stat. Ann. §§ 417.045 to -.240; La. Rev. Stat. Ann. §§ 9:4201 to -:4217; Me. Rev. Stat. Ann. tit. 14, §§ 5927 to 5949; Md. Code Ann., Cts. & Jud. Proc. §§ 3-201 to -234; Mass. Gen. Laws Ann. ch. 251, §§ 1 to 19; Mich. Comp. Laws Ann. §§ 600.5001 to -.5035; Minn. Stat. Ann. §§ 572.08 to -.30; Mo. Rev. Stat. §§ 435.350 to -.470; Mont. Code Ann. §§ 27-5-111 to -324; Neb. Rev. Stat. §§ 25-2601 to -2622; Nev. Rev. Stat. §§ 38.206 to -.248; N.H. Rev. Stat. Ann. §§ 542:1 to -:11; N.J. Rev. Stat. §§ 2A:24-1 to -11; N.M. Stat. Ann. §§ 44-7A-1 to -32; N.Y. C. P. L. R. §§ 7501 to 7514; N.C. Gen. Stat. §§ 1-569.1 to -.31; N.D. Cent. Code §§ 32-29.3-01 to -29; Ohio Rev. Code Ann. §§ 2711.01 to -.16; Okla. Stat. Ann. tit. 15, §§ 801 to -818; Or. Rev. Stat. §§ 36.600 to -.740; 42 Pa. Cons. Stat. Ann. §§ 7301 to -7320; R.I. Gen. Laws §§ 10-3-1 to -21; S.C. Code Ann. §§ 15-48-10 to -240; S.D. Codified Laws Ann. §§ 21-25A-1 to -38; Tenn. Code Ann. §§ 29-5-301 to -320; Tex. Civ. Prac. & Rem. Code § 171.001 to -.055; Utah Code Ann. §§ 78-31a-101 to -131; Vt. Stat. Ann. tit. 12, §§ 5651 to 5681; Va. Code Ann. §§ 8.01-581.01 to -.016; Wash. Rev. Code. §§ 7.04.010 to -.220; Wis. Stat. §§

States have no ability to curb potential abuses of arbitration because no State policy is ever sufficiently compelling to outweigh the "national policy favoring arbitration" declared by this Court in *Southland*. A great benefit of federalism is that "the States may perform their role as laboratories for experimentation to devise various solutions where the best solution is far from clear." *United States v. Lopez*, 514 U.S. 549, 581 (1995) (Kennedy, J., concurring); *see also New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("Denial of the right to experiment may be fraught with serious consequences to the Nation."). As a result of *Southland*, the laboratories are closed.

The injury to the States caused by *Southland* outweighs any reliance interest private parties might have that could justify retaining it. As twenty-five law professors persuasively argued in a brief *amici curiae* filed in support of the respondents in *Green Tree Financial Corp. v. Bazzle*, "[f]ew legitimate expectations are settled by *Southland*." Brief of Law Professors as Amici Curiae in Support of Respondents, at 17, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (No. 02-634). Specifically, the professors note that the corporate drafters of arbitration agreements, rather than resting on settled expectations, "have been aggressively experimenting with arbitration agreements to find new ways to use them to limit their customers' or employees' remedies against them." *Id.* The twenty years since *Southland* have thus been characterized by "drafting parties' efforts to 'push the envelope,'" *id.*, to find new and exciting ways to defeat State consumer protection and labor laws and their attendant state-created rights and remedies.

As explained above, this case aptly demonstrates how effective a tool *Southland* has become. Florida's usury laws were designed to protect its citizens from the unscrupulous business practices of predatory lenders. On the basis of

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788.01 to -.18; Wyo. Stat. Ann. §§ 1-36-101 to -119.

Southland, Petitioner relies on its artful insertion of arbitration provisions into its boiler-plate consumer contracts to prevent Florida from enforcing this carefully calibrated consumer protection law. As explained above, *Southland*, not anything in "the FAA," denies a State's citizens access to the State's courts for adjudication of state-created rights arising out of contracts of adhesion that are themselves carefully calibrated to defeat those state-created rights.

II. *Prima Paint* does not compel enforcement of arbitration clauses embedded in criminally illegal agreements.

a. *Prima Paint* does not mandate separability of arbitration clauses under all circumstances.

The purpose of the FAA "was to make arbitration agreements as enforceable as other contracts, *but not more so*." *Prima Paint*, 388 U.S. at 404 n.12 (emphasis added). Thus while states may not "place arbitration clauses on an unequal 'footing'" with other contract provision, *Allied-Bruce*, 513 U.S. at 281, neither must they treat arbitration clauses more favorably than any other contract provision. Accordingly, nothing in *Prima Paint*, or, more importantly, in the text of the FAA or its legislative history supports the conclusion that Congress intended for arbitration clauses to be invariably separable.

The Florida Supreme Court in this case refused to enforce the arbitration clause at issue upon a ground that "exist[s] at law or in equity for the revocation of any contract," *see* 9 U.S.C. § 2; *Allied-Bruce*, 513 U.S. at 281—specifically, that no provision of a facially criminal agreement can ever be enforced, *see Cardegna*, 894 So. 2d at 864. Respondents alleged and offered evidence tending to establish that Petitioner is a "loan shark", 687.071(1)(f), Fla. Stat., guilty of systematic felonious conduct under Florida's usury laws, *see id.* § 687.071(3). The Florida Supreme Court declared, as a matter of sound public policy, that

treating the arbitration clause differently from any other provision would "breath[e] life into a potentially illegal contract." *Cardegna*, 894 So. 2d at 864.

The Florida Supreme Court's decision to treat the arbitration clause *exactly like any other contract provision* is fully consistent with the plain language of section 2 of the FAA, with *Southland*, and with every other decision in which this Court has applied "FAA preemption." Each of these decisions involved state laws that specifically targeted and disfavored arbitration clauses. *Doctor's Assocs.*, 517 U.S. at 687 (FAA preempted statutory notice requirement applicable only to arbitration clauses); *Allied-Bruce*, 513 U.S. at 269 (FAA preempted statute providing that all pre-dispute arbitration agreements were invalid and unenforceable); *Perry*, 482 U.S. 490-91 (FAA preempted statute precluding enforcement of arbitration in wage collection actions); *Southland*, 465 U.S. at 17 n.11 ("[T]he defense to arbitration found in the California Franchise Investment Law is not a ground that exists at law or in equity 'for the revocation of any contract' but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the California Franchise Investment Law.").

The Court made clear in each of these cases that it was a state law's disfavored treatment of arbitration that rendered it inconsistent with section 2 of the FAA. Although discriminatory state laws were preempted, the Court explained that "the text of § 2 declares that state law may be applied 'if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.'" *Doctor's Assocs.*, 517 U.S. at 686-87 (quoting *Perry*, 482 U.S. at 493, n.9). "[A]bsent an 'unmistakably clear' expression of intent to 'alter the usual constitutional balance between the States and the Federal Government,' . . . a statute [should be interpreted] to preserve rather than destroy the States' substantial sovereign powers." *Pennsylvania Dep't of Corr. v. Yeskey*, 524 U.S. 206, 208-09

(1998) (quoting *Gregory*, 501 U.S. at 460-61); *see also* discussion *supra* § I.a.

Here, the Florida Supreme Court's conclusion that "there are no severable, or salvageable, parts" of a criminally illegal agreement, *Cardegna*, 894 So. 2d at 864, is, indisputably, a nondiscriminatory "law [that] arose to govern issues concerning the validity, revocability, and enforceability of contracts generally," *Perry*, 482 U.S. at 492, n.9. Nothing in *Prima Paint* prevents states from depriving parties of all rights under an illegal contract. The FAA does not therefore prohibit states from refusing to enforce any provision in an illegal contract as a matter of sound public policy designed to protect consumers and provide a sanction to deter unlawful conduct. To hold otherwise would be to infringe impermissibly on state sovereignty.

"[A] contract the terms of which themselves are contrary to public policy" is "totally void, i.e., without any legal effect." *Oubre v. Entergy Operations*, 522 U.S. 422, 431 (1998) (Breyer, J., concurring) (citing Restatement (Second) of Contracts § 7 cmt. a). The States have always been free to create public welfare laws and to prevent enforcement of agreements that violate those laws. Accordingly, Congress could not possibly have intended that the "making of [an] agreement for arbitration" not be "in issue," 9 U.S.C. § 4,[11] when it is part and parcel of an agreement that is criminally illegal under governing state law.

Relying on *Prima Paint*, and the subsequent circuit court decisions purporting to apply *Prima Paint* to illegal contracts, Petitioner attempts to characterize the arbitrability issue as simply a matter of rigorously enforcing private agreements. "After all," Petitioner notes, "'[t]he liberal federal policy

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[11] The textual basis for the *Prima Paint* separability rule is section 4 of the FAA, which, by its clear terms, applies only in federal court proceedings. *See* discussion *infra* § II.b.; *compare Southland*, 465 U.S. at 10 ("Congress withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration . . . *[i]n enacting § 2 of the [FAA].*") (emphasis added).

favoring arbitration agreements . . . is at bottom a policy guaranteeing the enforcement of private contractual arrangements,' and 'as with any other contract, the parties' intentions control.'" Brief For Petitioner at 21 (quoting *Mitsubishi Motors*, 473 U.S. at 625). But the issue here transcends the mere intention of the parties.

In Florida, as in every other State, parties are generally free to dictate the terms of their contractual relationships. However, freedom of contract principles must and do occasionally yield to countervailing health, welfare, and safety concerns of the States. Where, pursuant to controlling state law, an illegal contract is not a contract, there is likewise no agreement to arbitrate which ever came into existence. Accordingly, the "making of [an] agreement for arbitration" must be at issue if the arbitration clause is contained in an illegal agreement that violates governing state law. If it were otherwise, private parties would have unlimited license to trump public welfare laws in the context of arbitration. In short, nothing in the FAA or *Southland* or *Prima Paint* forces States to "breath[e] life into . . . potentially illegal contract[s]," *Cardegna*, 894 So. 2d at 864, irrespective of whether the parties voluntarily agreed to break the law.

Often state contract law is the principal means by which the State can protect consumers from commercial enterprises that seek to take advantage of unequal bargaining positions. For example, the purpose of Florida's usury laws is "to bind the power of creditors over necessitous debtors and prevent them from extorting harsh and undue terms in the making of loans." *Chandler v. Kendrick*, 146 So. 551, 552 (Fla. 1933), *quoted in Jersey Palm-Gross v. Paper*, 658 So. 2d 531, 534 (Fla. 1995). States have a compelling interest in policing these contractual relationships to help level the playing field between consumers and commercial parties. The Court should not hold that commercial parties can circumvent a state's consumer protection

laws merely through the artful insertion of an arbitration clause in its contracts of adhesion.

The allegations at issue in *Prima Paint*, fraudulent inducement, relate solely to the particular aspects of the bargaining process between the parties. By contrast, the allegations herein of criminal illegality involve the overriding interests of the State in public welfare and consumer protection. The analytical focus shifts away from the specific parties to the particular contract and lands squarely within the arena of permissible state public policy. This Court could not possibly have intended the holding in *Prima Paint* to inhibit the States' sovereign authority to police criminally illegal contracts.

b. The *Prima Paint* separability rule applies only in federal court proceedings.

Even if this Court were to conclude *Prima Paint* requires separability of an arbitration clause under all circumstances, including where such clause is imbedded in an illegal contract, the rule would nevertheless apply only in federal court. The holding of *Prima Paint*—that federal courts lack jurisdiction to consider whether a contract containing an arbitration clause had been induced by fraud before compelling arbitration, unless the claim was directed at the arbitration clause itself—rested principally on its construction of *sections 3 and 4 of the FAA*. *Prima Paint*, 388 U.S. at 405-07. Sections 3 and 4 set forth the *procedural mechanisms* through which the *federal courts* must enforce arbitration agreements subject to the Act. By the clearest of terms, sections 3 and 4 do not apply in state court proceedings.

Section 3 creates a stay of proceedings mechanism for suits "brought in any of the courts of the United States." 9 U.S.C. § 3. The phrase "courts of the United States" used in a federal statute refers to Article III courts and certain Article I courts created by Congress, but not to state courts. *See* 28 U.S.C. § 451 (defining "court of the United States" as used in chapter 28); *see also Southland*, 465 U.S. at 29 (O'Connor, J.,

dissenting) ("§ 3's 'courts of the United States' is a term of art whose meaning is unmistakable. State courts are 'in' but not 'of' the United States."), *cited in Volt*, 489 U.S. at 477 n.6. Section 4 provides a mechanism by which "[a] party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition *any United States district court* . . . for an order directing that such arbitration proceed in the manner provided for in such agreement." *Id.* § 4 (emphasis added).

The separability principle announced in *Prima Paint* was entirely dependent on its construction of sections 3 and 4. In rejecting the First Circuit's conclusion "that the question of 'severability' is one of state law" in diversity proceedings, the Court explained that section 4 "provided an explicit answer"—but only "[w]ith respect to cases brought in federal court involving maritime contracts or those evidencing transactions in 'commerce.'" *Prima Paint*, 388 U.S. at 403. Section 4 provides, in relevant part, that a federal court may compel arbitration once it is satisfied that "the making of the agreement for arbitration . . . is not in issue." 9 U.S.C. § 4, *quoted in Prima Paint*, 388 U.S. at 403. Construing the language of section 4, the Court held that a claim of fraudulent inducement does not place "the making of the agreement for arbitration . . . in issue" unless "the claim is fraud in the inducement of the arbitration clause itself." *Prima Paint*, 388 U.S. at 403-04. Accordingly, the Court held that "in passing upon *a § 3 application for a stay* while the parties arbitrate, *a federal court* may consider only issues relating to the making and performance of the agreement to arbitrate." *Prima Paint*, 388 U.S. at 404 (emphasis added).

The Court in *Prima Paint* concluded Congress had the authority to create the separability rule in federal court because "the question is whether Congress may prescribe *how federal courts are to conduct themselves* with respect to subject matter over which Congress plainly has power to legislate." *Prima Paint*, 388 U.S. at 405 (emphasis added). Neither Congress, in

the FAA, nor this Court in *Prima Paint*, sought to prescribe analogous rules for state courts.

CONCLUSION

For the foregoing reasons, the decision of the Florida Supreme Court should be affirmed.

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FILED
SEP 23 2005
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 04-1264

In The Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN CARDEGNA, ET AL.,

Respondents.

On Writ Of Certiorari To The Supreme Court Of The State Of Florida

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QUESTION PRESENTED

When state contract law requires state courts to determine whether a contract is criminal and void *ab initio* before enforcing any of the contract's provisions, including an arbitration provision, does the Federal Arbitration Act ("FAA") preempt that state law and nonetheless require the state court to compel arbitration before determining whether a contract exists?

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INTRODUCTION

The Supreme Court of Florida held below that a court must resolve allegations that an agreement is criminal and void *ab initio* before it enforces any of the agreement's provisions, including an arbitration provision. This decision was based on generally applicable rules of Florida contract law providing that agreements whose principal purpose is the commission of a crime are void *ab initio* in their entirety, meaning that no "contract" to perform any aspect of these agreements ever comes into existence.

Petitioner Buckeye Check Cashing, Inc. ("Buckeye") does not dispute the decision below *if* state law controls whether state courts enforce arbitration clauses in agreements that are void *ab initio*. Buckeye maintains, however, that the FAA preempts generally applicable rules of state law on this issue and requires Florida state courts to enforce arbitration clauses in agreements before and without determining whether those agreements are criminal and void *ab initio* under Florida law. Buckeye claims that this case is governed, and Florida law is preempted, by *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967). In that case, this Court held for cases in federal court that, when two parties have agreed to arbitrate disputes arising out of a contract, and one of them argues that the entire contract (as opposed to the arbitration clause in particular) is voidable under a defense such as fraudulent inducement, the arbitrator – not the court – should resolve the challenge to the enforceability of the entire contract. Under this rule of "separability," federal courts are directed to examine certain defenses to the enforceability of an arbitration clause separately from defenses to the enforceability of the contract as a whole.

Prima Paint, however, does not govern this case, which is a state court case (not a federal court case) and which involves an agreement that is allegedly void *ab initio* (not a validly formed contract allegedly voidable as a defense). Buckeye's attempt to extend *Prima Paint* to preempt Florida state law in this case cannot overcome the presumption against preemption of state law. It is contrary both to the plain language of the FAA and the principles set forth in this Court's decisions interpreting the FAA.

STATEMENT OF THE CASE

A. Plaintiffs' Allegations.

This putative class action was brought under Florida state law by respondents John Cardegna and Donna Reuter ("Plaintiffs") on behalf of a class of Florida consumers against Buckeye. Plaintiffs allege that Buckeye, falsely portraying itself as a legitimate check cashing service, illegally charged and collected usurious interest from thousands of Plaintiffs through repeated violations of various Florida statutes.[1]

Plaintiffs' Complaint alleges that Buckeye lent money to Plaintiffs under terms specified in form agreements. J.A. 15. The form agreements contained an "Arbitration

[1] Plaintiffs alleged that Buckeye's practices violated Florida's Lending Practices Act, Chapter 687, Florida Statutes; Florida's Consumer Finance Act, Chapter 516, Florida Statutes; Florida's Deceptive and Unfair Trade Practices Act, Chapter 501, Part II, Florida Statutes; and Florida's Civil Remedies for Criminal Practices Act, Chapter 772, Florida Statutes. Joint Appendix ("J.A.") 25-32.

Provision" purportedly requiring the parties to arbitrate any disputes that they might have, on the second page of the agreement, under the heading of "Additional Terms and Conditions," along with other terms such as a "Dishonored Check Fee." *E.g.*, J.A. 36. In each transaction, Plaintiffs gave Buckeye a personal check and agreed that the face value of the check would be paid within a short time period, usually two weeks. In exchange, Buckeye gave Plaintiffs cash in an amount less than the face value of the check. In each transaction, Buckeye agreed to hold the check until the next payday or until the Plaintiff received her or his next Social Security or other government check. *E.g.*, J.A. 17.

The complaint alleges that the rate of interest charged by Buckeye on each transaction ranged from 137% to 1,317% A.P.R. (depending on several factors, including the length of the loan), and the rate was usually over 300% A.P.R. *E.g.*, J.A. 35, 37, 39, and 41. Plaintiffs allege that the essence of each transaction is lending money at highly usurious rates of interest and that the agreements were criminal on their face.[2]

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[2] In another case currently pending, the Florida Supreme Court is considering whether identical transactions are usurious loans. In *McKenzie Check Advance of Fl. v. Betts*, No. SC04-1825, the payday lender defendant argues (as Buckeye argued below) that it has not violated Florida law because it does not make loans, but instead merely charges a check cashing fee, and is therefore supposedly not subject to Florida's laws against loan sharking. No party has asked this Court to resolve the question whether Buckeye's conduct involves lending within the meaning of Florida statutory law. Nonetheless, some of Buckeye's *amici* have asserted that the agreements in this case are legal. *E.g.*, *Amicus* Brief of the Consumer Financial Services Association ("CFSA") at 3. Without responding here to the argument as to whether the transactions involved in this case are "loans,"and thus subject to usury

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Chapter 687 of the Florida Statutes provides felony sanctions for such usurious lending. The threshold for first degree misdemeanor criminal usury is 25% per annum, § 687.071(2), Fla. Stat. (2001). Lending money at an interest rate in excess of 45% per annum is a third degree felony. § 687.071(3), Fla. Stat. (2001). Lending money at either the misdemeanor or felony levels of usury is defined as "loan sharking." § 687.071(1)(f), Fla. Stat. (2001). The instant agreements provide for interest rates as high as twenty-nine times the felony threshold. The written agreements themselves are criminal contraband under Florida law. Fla. Stat. § 687.071(5) (2001).

B. The Proceedings Below.

This case was filed in Florida state court. J.A. 1. Shortly thereafter, Buckeye removed it to federal court. J.A. 6. In the district court, Buckeye petitioned to compel Plaintiffs to arbitrate. *Id.* Plaintiffs moved to remand, however, and the district court, upon finding that it had no jurisdiction, granted that motion. J.A. 7. That ruling is not challenged here.

On remand, Buckeye filed another motion to compel arbitration in the state trial court. Plaintiffs opposed the

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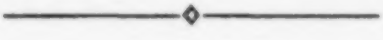
laws, it is worth noting that Buckeye's agreement identifies an "Annual Percentage Rate," *e.g.*, J.A. at 35; and a "Finance Charge." *Id.* The agreement also explains that certain disclosures are being made pursuant to the "Truth in Lending Act," and discloses that the "rate of interest charged is higher than that on substantially similar *loans*." *Id.* (emphasis added). While Buckeye and other payday lenders eventually obtained legislation that they argue prospectively exempts them from the state's usury laws (a proposition that Plaintiffs dispute), that legislation does not help them here because it was not in effect at the time these loans were made.

motion on the grounds, among others, that the entire contract was criminal and void *ab initio*. Buckeye argued that illegality was an issue for an arbitrator, not a court, to decide, citing *Prima Paint*. Plaintiffs responded that *Prima Paint* does not apply to this case. Plaintiffs also argued that the text of the FAA does not support Buckeye's efforts to compel arbitration here. The state trial court denied Buckeye's motion to compel arbitration. Buckeye appealed to the District Court of Appeals, which reversed the trial court.

The Florida Supreme Court reversed the District Court of Appeals. Petition Appendix ("P.A.") 1a-26a. It held that, before a Florida state court can compel arbitration of a case, the court, not an arbitrator, must first decide whether a contract exists at all under Florida law. It held that "Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract." P.A. 7a. The Court cited Florida case law involving illegal contracts (that did not involve arbitration issues) dating back more than half a century. *Id.* (citing *Wechsler v. Novak*, 26 So.2d 884, 887 (1946) (involving an attempt to influence a government official)). The court below also relied on a leading treatise on arbitration law for the proposition that "[c]ontracts in violation of statutory prohibitions are void, and issues arising under such contracts are therefore not arbitrable." *Id.* (quoting *R.P.T. of Aspen, Inc. v. Innovative Comm, Inc.*, 917 P.2d 340 (Colo. Ct. App. 1996), citing 2 Martin Domke, *Commercial Arbitration* 8.06 (rev. ed. 1995)). This appeal followed.



SUMMARY OF ARGUMENT

Buckeye argues that the state law applied in the decision below conflicts with, and thus is preempted by, the FAA. Although Buckeye identifies no language in the FAA to support this theory, it argues that the decision below is contrary to the separability principle that this Court recognized in *Prima Paint*. Buckeye argues that *Prima Paint* holds that only an arbitrator – and not a state court – can decide any challenge to a contract, even a challenge to whether a contract was formed or exists at all, if the challenge relates to the entire contract and not just the arbitration clause. Pet. Br. at 1. Buckeye further argues that any state law providing that a state court should not enforce an arbitration clause in a criminal agreement that is void *ab initio* is preempted. The only exception that Buckeye acknowledges is if a challenge is raised to a party's assent to a contract as a whole.

Buckeye's argument, however, must overcome the heavy presumption against preempting state law in areas – such as the law of contract formation – traditionally governed by state law. This presumption should be decisive here, because this Court also has held that federal law does not preempt state law where federal law provides no guidance on an issue – and there are no applicable principles of federal law governing the question of what is a "contract."

Against this backdrop, the decision below must stand. As a threshold matter, the separability rule enunciated in *Prima Paint* cannot preempt state law in this case, because the arbitration issues here arose in Florida state court. *Prima Paint*'s holding was grounded in the language of 9 U.S.C. § 4, which on its face only establishes a

procedural rule for federal court proceedings. Section 4 applies to petitions brought in "any United States district court." Section 3, which the Court held also incorporates a separability rule, likewise only applies to suits "brought in any of the courts of the United States." It was appropriate for this Court to apply Section 4 in *Prima Paint*, because that case was an appeal from federal courts. Because the arbitration issues in this case arose in state court proceedings, however, *Prima Paint* has no application here.

Buckeye really is asking this Court to extend *Prima Paint* to preempt state law in state court cases, and to enforce arbitration clauses in agreements that are void *ab initio* under generally applicable rules of state law, not just valid contracts allegedly voidable by one party as a defense. That attempt to extend *Prima Paint* is contrary to the FAA itself.

Buckeye never identifies which provision of the FAA it is relying on, but Section 2 of the Act is the only provision that this Court has held applies in state courts. Buckeye's argument, however, is directly contrary to the language of Section 2. Section 2 says that arbitration provisions are enforceable when they are found "*in*" a "*contract*," or when there is an agreement to arbitrate an existing controversy that "*arises out of*" a "*contract*." Buckeye argues that the separability rule must be applied and arbitration provisions must be enforced whenever there is assent (or an agreement) to an arbitration provision. The language of the statute, however, provides that such agreements are enforceable only when they are found in a contract or when they relate to a controversy that arises out of a contract. Accordingly, the question of whether a contract exists is a threshold issue that must be resolved *before* a court can begin to enforce the FAA.

This case involves the threshold issue of whether a contract exists. Under generally applicable principles of Florida law – and that of most other jurisdictions – an agreement to perform a criminal act does not form a *contract*. There may be an agreement to sell cocaine, for example, but there is no such thing under Florida law as a "*contract*" to sell cocaine (much less an enforceable arbitration provision in a "contract" to sell cocaine). That principle governs this case. Plaintiffs colorably allege that Buckeye charges interest rates that violate Florida's criminal laws and that Buckeye's payday lending agreement is, therefore, void *ab initio*. As the court below held, under general principles of Florida contract law, no contract is ever formed by an agreement that violates a statute. P.A. 6a. Plaintiffs' arguments in this case thus go to the existence and formation of the contract in the first instance, an issue that a court must resolve before the FAA comes into play.

Buckeye's proposed extension of *Prima Paint* also is contrary to the scheme of the statute. This Court has repeatedly directed, including in *Prima Paint* itself, that "the purpose of Congress [in enacting the FAA] in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so." 388 U.S. at 404 n.12. Under longstanding principles of Florida law applicable to all contracts, courts may not enforce any provision of a contract if its primary purpose is criminal. Buckeye's proposed extension of *Prima Paint* would be only valid if this Court were to read Section 2 of the FAA as establishing a new federal law of contract formation that made arbitration agreements more enforceable than all other types of contracts. For all of these reasons, Buckeye's preemption

arguments should be rejected and the decision below should be affirmed.

ARGUMENT

I. BUCKEYE MUST OVERCOME A HEAVY PRESUMPTION AGAINST PREEMPTION OF ORDINARY STATE CONTRACT LAW RULES.

There is no dispute that, if Florida law governs the question of whether a contract was formed in this case, and whether a state court or an arbitrator decides that question, Plaintiffs prevail. Buckeye does not dispute that generally applicable Florida contract law renders agreements to commit a crime void *ab initio* in their entirety, and thus that, under Florida law, a court must decide whether an agreement is void *ab initio* before enforcing any provision in it, including an arbitration provision. Instead, Buckeye argues that federal law overrides and preempts Florida law. *E.g.*, Pet. Br. at 1 ("state law has nothing to do with the real issue"). Buckeye essentially argues that federal law requires state courts to recognize an exception to the normal principles of contract law governing illegal agreements. This new rule of federal contract law would apply only to arbitration clauses, and would require both federal and state courts to enforce arbitration provisions in circumstances where they would not enforce other types of contract terms.

This case thus must be analyzed in light of the strong presumption against federal preemption of state contract law. This Court has directed repeatedly that, "[i]n areas of traditional state regulation, we assume that a federal statute has not supplanted state law unless Congress has

made such an intention 'clear and manifest.'" *Bates v. Dow Agrosciences*, 125 S. Ct. 1788, 1801 (2005) (internal citations omitted). The presumption against preemption applies both to the existence of preemption and the scope of preemption. *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 484-485 (1996). The presumption helps ensure that the balance between federal and state power will not be disturbed unintentionally by Congress or unnecessarily by the courts. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

Contract law is an area traditionally governed by state law. While there is a body of federal common law governing contracts in a few narrow areas (such as in collective bargaining disputes governed by the federal labor laws or in certain maritime settings), few areas of law have been more deeply entrusted to the states than the law of contract formation.[3]

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[3] *See, e.g., Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 84 (1982) ("the cases before us, which center upon appellant Northern's claim for damages for breach of contract . . . , involve a right created by *state* law. . . ."), 458 U.S. at 90 (Rehnquist, J. and O'Connor, J., concurring) ("the lawsuit . . . seeks damages for breach of contract . . . which are the stuff of traditional actions at common law. . . . There is apparently no federal rule of decision provided for any of the issues in the lawsuit; the claims . . . arise entirely under state law."); *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 262 (1979) ("[C]ommercial agreements traditionally are the domain of state law. State law is not displaced merely because the contract relates to intellectual property which may or may not be patentable"); *Pan Am. Petroleum Corp. v. Superior Court*, 366 U.S. 656, 663 (1961) (contract dispute) ("The suits are thus based upon claims of right arising under state, not federal law. . . . The rights as asserted by Cities Service are traditional common law claims."); *Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22, 40 (1988) (Scalia, J., dissenting) ("Nor can or should courts

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The presumption against preemption is also particularly strong here because Buckeye is proposing a federal rule to govern the procedures that state courts should follow. The court below held that state courts should decide the threshold issue of whether a contract exists before sending a case to arbitration. Buckeye is insisting that federal law requires that a different procedure be followed. There is a very strong presumption against federal preemption in this setting, as federal law recognizes that states traditionally may adopt their own rules on procedural issues. *E.g., Howlett v. Ross*, 496 U.S. 356, 372 (1990) ("The states thus have great latitude to establish the structure and jurisdiction of their own courts."); *Southland Corp. v. Keating*, 465 U.S. 1, 33 (1984) (O'Connor, J., dissenting) ("The general rule, bottomed deeply in belief in the importance of state control of state judicial procedure, is that federal law takes the state courts as it finds them. Some differences in remedy and procedure are inescapable if the different governments are to retain a measure of independence in deciding how justice should be administered.") (quoting Hart, "The Relations Between State and Federal Law," 54 Colum. L. Rev. 489, 508 (1954)).

In light of this heavy presumption, this Court has held that federal law may preempt state law in only three circumstances: (a) when Congress has expressly provided for preemption; (b) when Congress intends for federal law to occupy a field; or (c) where state law conflicts with a federal statute. *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 371 (2000). As this Court has recognized,

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ignore that issues of contract validity are traditionally matters governed by state law.").

however, "[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989). Therefore, the FAA can displace state law only through the doctrine of implied conflict preemption. *Id.* at 477-78.

In order to establish that the FAA impliedly preempts Florida's contract law holding that agreements to commit a crime are void *ab initio* in their entirety, Buckeye must demonstrate that there is an "actual conflict" between federal and state law, either because it is "impossible for a private party to comply with both . . . requirements" or because the state laws "stand[] as an obstacle to the accomplishment and execution of full purposes" of Congress. *Freightliner Corp. v. Myrick*, 514 U.S. 280, 287 (1995) (citations omitted). This Court has also rejected claims of preemption where no federal law addresses the subject that state law is regulating. *See, e.g., Freightliner*, 514 U.S. at 289-90 (unanimous holding that common-law claims involving a manufacturer's failure to install antilock brakes in trucks are not preempted by the Motor Vehicle Safety Act because "[t]here is no express federal standard addressing [antilock brakes] for trucks or trailers."). Accordingly, Buckeye has the burden of establishing that federal law addresses and conflicts with state law with respect to the subject matter at issue here – the formation of contracts.

To establish that federal law preempts state law in this area, Buckeye must point to specific language in the FAA that conflicts with – and thus overrides – state law. In determining whether a state rule of law is preempted by federal law, a court's "sole task is to ascertain the intent of

Congress." *California Fed. Sav. & Loan Ass'n v. Guerra*, 479 U.S. 272, 280 (1987) (plurality). The most reliable indicator of Congress' intent, of course, is its own language. *E.g., Nixon v. U.S.*, 506 U.S. 224, 232 (1993) ("the well-established rule [is] that the plain language of the enacted text is the best indicator of intent.") As will be shown, the plain language of the FAA shows that Buckeye is wrong and that Congress did not intend to displace the state law principles applied by the state court below.

II. *PRIMA PAINT* INTERPRETED 9 U.S.C. §§ 3 AND 4, WHICH DO NOT APPLY TO THIS *STATE COURT* CASE.

Buckeye's argument that Florida law is preempted by this Court's decision in *Prima Paint* should be rejected because that decision was based on sections of the FAA that, by their own terms, have no application in state court cases like this one. *Prima Paint* held that the separability rule was dictated by the language of 9 U.S.C. § 4, and that it applies equally to cases governed by 9 U.S.C. § 3. Both of these provisions, however, create procedural rules that on their face apply only in federal district court cases where there is an independent basis for federal court jurisdiction. Because this case, unlike *Prima Paint*, is on appeal from state court proceedings, there is no statutory basis for applying *Prima Paint*'s separability rule here.[4]

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[4] This argument against extending *Prima Paint* to the facts of this case is properly before the Court. The Florida Supreme Court recognized the argument in distinguishing federal court cases based on differences in controlling law, noting that federal cases to the contrary were based upon federal law, *see* 894 So.2d at 864 ("However, the case before us is distinguishable because *Bess* [*v. Check Express*, 294 F.3d

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The Court granted review in *Prima Paint* to resolve a circuit split over whether a federal court or an arbitrator decides allegations that a contract with an arbitration clause was induced by fraud, and whether this determination of who decides is governed by the FAA or state law. *See Prima Paint*, 388 U.S. at 402. In holding that the FAA creates a separability rule requiring federal courts to refer fraud allegations to an arbitrator if they do not implicate the validity of the arbitration clause, the Court found that this result was compelled by the language of 9 U.S.C. § 4:

> *With respect to cases brought in federal court* involving maritime contracts or those evidencing transactions in "commerce," we think that Congress has provided an explicit answer. That answer is to be found in § 4 of the Act, which provides a remedy to a party seeking to

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1298 (11th Cir. 2002)] was expressly resolved under federal law, not state law principles."), and that those cases were based on "the scope of the district court's authority under 9 U.S.C. § 4." 894 So.2d at 864. Moreover, even if it had not been explicitly addressed, this separate argument against extending *Prima Paint*'s separability principle to this case would fall within this Court's traditional rule that " 'once a federal claim is properly presented, a party can make *any argument* in support of that claim; parties are not limited to the precise arguments they made below.' " *Lebron v. Nat'l Railroad Passenger Corp.*, 513 U.S. 374, 379 (1995) (quoting *Yee v. City of Escondido*, 503 U.S. 519, 534 (1992)) (emphasis added). Finally, since the question presented is whether the rule of *Prima Paint* governs this case, the determination of whether *Prima Paint* and 9 U.S.C. §§ 3 and 4 *ever* apply in state court proceedings is "so integral to the decision of the case that [it] could be considered fairly subsumed by the actual question[ ] presented." *Kolstad v. American Dental Ass'n*, 527 U.S. 526, 540 (1999) (citation omitted)); *see also Caterpillar, Inc. v. Lewis*, 519 U.S. 61, 75 n.13 (1996) ("Under the facts of this case, however, addressing the implications of [28 U.S.C.] § 1446(b)'s one-year limitation is predicate to an intelligent resolution of the question presented. We therefore regard the issue as one fairly included within the question presented.") (citations omitted).

> compel compliance with an arbitration agreement. Under § 4, *with respect to a matter within the jurisdiction of the federal courts* save for the existence of an arbitration clause, the federal court is instructed to order arbitration once it is satisfied that "the making of the agreement for arbitration or the failure to comply (with the arbitration agreement) is not in issue."

Id. at 403 (emphasis added). The Court thus limited the scope of the question before it to the allocation of authority in "cases brought in federal court," and resolved that question based on a statutory provision that itself applies only to petitions for arbitration in "any *United States district court* which, save for such agreement, would have jurisdiction under Title 28." 9 U.S.C. § 4 (emphasis added). *Prima Paint* therefore does not, and cannot, determine who resolves the threshold contract challenge in this state court case.

Although *Prima Paint* relied on the language of 9 U.S.C. § 4 to support its holding, that case actually arose under 9 U.S.C. § 3. Like Section 4, Section 3 applies to "any suit or proceeding brought in any of the *courts of the United States* upon any issue referable to arbitration . . . " 9 U.S.C. § 3 (emphasis added). The Court's actual holding recognized that the separability rule applies under either provision governing proceedings in federal courts: "We hold, therefore, that in passing upon a § 3 application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate." *Prima Paint*, 388 U.S. at 404. Thus, neither *Prima Paint* nor the statutory provisions on which it relies purports to govern the allocation of authority between courts and arbitrators in *state court* proceedings.

This limitation to federal court proceedings was central to *Prima Paint*'s holding. After resolving the statutory interpretation issue, the Court had to address the constitutionality of what was arguably a federal law rule of decision in a diversity jurisdiction case. *Id.* at 404-05. In resolving this constitutional question, the Court flatly rejected the contention that it was creating federal substantive law for diversity cases and held instead that the severability rule was made pursuant to Congress's power to regulate procedural matters *in federal courts*:

> The question in this case, however, is not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases. Rather, the question is *whether Congress may prescribe how federal courts are to conduct themselves* with respect to subject matter over which Congress plainly has power to legislate. The answer to that question can only be in the affirmative.

Id. at 405 (emphasis added). The Court thus found that the separability rule, consistent with the plain language of Sections 3 and 4, is a rule of procedure governing the allocation of authority between federal courts and arbitrators that Congress created pursuant to its power to regulate proceedings in federal courts.[6] Therefore, Buckeye's argument for applying this separability rule to govern the state court proceedings here would call into question the constitutional underpinnings of *Prima Paint* itself.

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[6] *See also Bess*, 294 F.3d at 1306 n.3 ("In reaching our decision, however, we are not deciding questions of Alabama contract law; rather, we are deciding the scope of the district court's authority under 9 U.S.C. § 4, a question of federal law.").

Although this Court subsequently held that Section 2 of the FAA applies to state court proceedings, *see Southland Corp. v. Keating*, 465 U.S. 1, 10-11 (1984), it has never held that the procedural rules of Sections 3 and 4 at issue in *Prima Paint* also apply in state court and displace any different state laws. To the contrary, *Southland* disavowed any such intention by clarifying that, "[i]n holding that the Arbitration Act preempts a state law that withdraws the power to enforce arbitration agreements, we do not hold that §§ 3 and 4 of the Arbitration Act apply to proceedings in state courts." *Id.* at 16 n.10.[6] Likewise, in *Volt*, which held that the FAA does not preempt a state procedural rule allowing stays of arbitration when there is related litigation pending, the Court again explained that:

> While we have held that the FAA's 'substantive' provisions – §§ 1 and 2 – are applicable in state as well as federal court, we have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court, are nonetheless applicable in state court.

489 U.S. at 477 n.6. In light of these decisions recognizing the plain textual limitations of Sections 3 and 4 to cases in federal court, many state appellate courts have held that these provisions do not govern state court proceedings and

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[6] *Southland*'s disavowal on this point was made in response to Justice O'Connor's forceful dissent challenging both the statutory and constitutional bases for applying the FAA's procedural rules in Sections 3 and 4 to state courts. *See id.* at 29 ("§§ 3 and 4 are the implementing provisions of the Act, and they expressly apply only to federal courts.") (O'Connor, J., dissenting); *id.* at 31 n.20 ("[A]bsent specific direction from Congress the state courts have always been permitted to apply their own reasonable procedures when enforcing federal rights.").

thus do not preempt state laws addressing procedures for deciding arbitration-related issues.[7]

Buckeye's arguments for extending *Prima Paint*'s separability rule to state court proceedings thus cannot be squared with the FAA's plain language or the Court's interpretation of the Act in *Prima Paint* itself. Instead, both make clear that the separability rule is a matter of federal court procedure governing the allocation of authority between federal judges and arbitrators that applies *only* in federal court proceedings. Therefore, state courts may apply state law rules in determining the allocation of authority between courts and arbitrators, subject only to the FAA's preemptive neutrality requirement that state law not place agreements to arbitrate on a different or lesser footing than other contract terms. Since the contract law rule applied by the state court below in holding that Plaintiffs' threshold allegations of illegality are for courts to decide comports with this neutrality requirement (*see* Part III, *infra*), there is no basis in the FAA for reversing this determination. The decision below thus should be affirmed.

As the next section will make clear, *Prima Paint* does not apply for a second reason: it did not involve a question of contract formation. *Prima Paint* involved a voidability defense to a contract that had been formed, and not the

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[7] *See, e.g., Southern Cal. Edison Co. v. Peabody W. Coal Co.*, 977 P.2d 769, 774 (Ariz. 1999) (applying state law rule governing appeals); *Simmons Co. v. Deutsche Fin. Serv's Corp.*, 532 S.E.2d 436, 439-40 (Ga. App. 2000) (same); *Collins v. Prudential Ins. Co.*, 752 So.2d 825, 828-29 (La. 2000) (same); *Xaphes v. Mowry*, 478 A.2d 299, 301 (Me. 1984) (same); *Wells v. Chevy Chase Bank*, 768 A.2d 620, 625-26 (Md. 2001) (same); *Jack B. Anglin Co. v. Tipps*, 842 S.W.2d 266, 272 (Tex. 1992) (same).

threshold issue of whether a contract had been formed at all. Buckeye's reading of *Prima Paint* ignores the crucial distinction between a void and voidable contract. In its brief, Buckeye insists that the distinction between voidable contracts and documents that are void *ab initio* and never form contracts is one "without a difference." *E.g.*, Pet. Br. at 1. As will shortly be seen, these arguments can only be advanced if one assumes that federal law requires state courts to disregard the language of the statute and core principles of contract law.

III. BUCKEYE'S PROPOSED EXTENSION OF *PRIMA PAINT* IS CONTRARY TO THE PLAIN LANGUAGE OF SECTION 2 OF THE FAA AND THIS COURT'S DECISIONS INTERPRETING IT.

Given that *Prima Paint*, by its own terms, does not apply to state court cases, the next question is whether there is any statutory basis for *extending Prima Paint* to cases, like this one, that arise in the state courts. As we now explain, the answer is clearly "no." Under this Court's normal approach to questions of federal preemption, a party asking a court to hold that some body of state law is preempted by federal law must identify a rule of federal law – either in a statute or a regulation – that allegedly preempts the state law. Before a court can turn to the question of whether state law conflicts with federal law, it must first determine whether there *is* any federal law governing the matter in dispute.

Aside from its misguided reliance on *Prima Paint*, Buckeye has not identified any language in the FAA that it claims preempts Florida state law here. The only provision of the FAA that this Court has ever found to have any preemptive effect, however, is Section 2. Accordingly, while

Buckeye's brief is unclear on the point, it appears that what Buckeye is really saying is that this Court should re-interpret its decision in *Prima Paint* as being based upon Section 2 of the Act, and then extend this new interpretation of Section 2 to create a new rule of preemptive federal law.

Buckeye's proposed extension of *Prima Paint*, however, is fatally flawed at the core. It contradicts both the plain language of Section 2 itself and this Court's jurisprudence in several respects.

A. Under the FAA, a Court Must Find that a Contract Exists Before an Arbitration Clause May Be Enforced.

1. Section 2 Only Authorizes Enforcement of an Arbitration Clause that Is "In" a "Contract."

Like Sections 3 and 4, Section 2 also bars Buckeye's attempt to extend *Prima Paint* to preempt state law in this case, because Section 2 provides that arbitration clauses are enforceable when they are "in" a contract or relate to a controversy that is "arising out of" a "contract." Under the plain language of the statute, therefore, any separability principle requiring the enforcement of an arbitration clause could apply only in cases (like *Prima Paint* itself) where there is no dispute that a contract has been *formed*. In *Prima Paint*, this Court faced a situation where a contract unquestionably *existed*, but that contract was arguably voidable and subject to a defense from one party (fraudulent inducement). 388 U.S. at 401 (the case involved a "contract" in interstate commerce). In this case, however, Plaintiffs allege that no contract was ever

formed. And Section 2, by its terms, does not apply if no contract exists.

Section 2 of the FAA provides only for the enforcement of arbitration provisions which are found (1) "in . . . a contract" or (2) which are agreements to arbitrate an existing controversy "arising out of . . . a contract." Section 2 of the Act states:

> A written provision *in* any maritime transaction or a *contract* evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy *arising out of such a contract*, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (Emphasis added.)

In other words, the Act provides that, in non-maritime cases (such as this one), written provisions for arbitration must be "*in*" a "*contract*," or must be an agreement to arbitrate an existing controversy that is "arising out of such a contract," to be "enforceable." The definition of the word "in" is "contained or enclosed by; inside; within." Webster's New World Dictionary (3d College Ed. 1988) ("Websters").[8] Thus, when the FAA says that a provision to

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[8] "When the terms in a statute are undefined, we give them their ordinary meaning." *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995). *See also Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("In the search for statutory meaning, we give nontechnical words and phrases their ordinary meaning.") Accordingly, it is entirely appropriate for this

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arbitrate is enforceable if it is "in" a contract, the agreement must be "contained or enclosed by" a contract, "inside" a contract, or "within" a contract. Similarly, the word "arise" means "to result or spring *from* something." Webster's at 74 (emphasis in original). When the FAA says that an agreement to arbitrate is enforceable if it involves a controversy that "arises out of" a contract, then the controversy must "result or spring from" a contract. Buckeye's provision does not meet any of those requirements, because it is set forth in an illegal agreement that, under Florida law, never constituted a contract in the first place.

Buckeye argues that as a matter of federal law, when there is a challenge to the formation of a contract that contains an arbitration provision, the question of whether a contract was formed is one that must be answered by an arbitrator – and not a court. Buckeye acknowledges only one exception to this proposed federal rule – when the challenge to the formation of the contract involves the issue of assent. *E.g.*, Pet. Br. at 1. But that position is contrary to the language of § 2 of the FAA. As just noted, an arbitration provision is only enforceable if it is "in" a "contract" or "arises out of" a controversy that arises from a "contract." By focusing solely upon assent, Buckeye confuses the idea of an agreement with a contract. Whenever two parties assent to something, they may have an agreement, but that does not mean that they have a "contract." The terms are not synonymous. In Florida (as in many other states), for example, two parties may each

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Court to look at dictionary definitions to give words their ordinary meaning. *See, e.g., Chapman v. United States*, 500 U.S. 453, 461-65 (1991).

assent to an arrangement which has the principal purpose of committing a felony, but while this assent gives rise to an agreement, it decidedly is not a "contract." Section 2 of the FAA only provides for the enforcement of those arbitration agreements that are "in" or that involve controversies that "arise out of" *contracts*. Indeed, Buckeye's proposal is untethered to any statutory language at all. Buckeye effectively suggests that this Court treat the FAA as a general command that federal law requires the enforcement of arbitration clauses as often as possible, a position that cannot be squared with the limitations of the statute's language.[9]

As Buckeye conceives of the separability doctrine of *Prima Paint*, its agreement here really constitutes two separate agreements. One is a written agreement containing terms that provide for Buckeye to give cash to Plaintiffs in exchange for interest and fees, and the second is an agreement to arbitrate disputes. Pet. Br. at 18. Because these two agreements are supposedly separate, Buckeye argues that it is appropriate to enforce the agreement to arbitrate even if the principal purpose of the agreement as a whole is illegal. Buckeye's position is not consistent with Section 2 of the Act. Section 2 does not speak of agreements to arbitrate as "contracts" standing alone and apart from the rest of a contract that addresses other issues. Instead, Section 2 of the FAA speaks of arbitration "provisions" or "agreements" that are enforceable when they are

[9] It also is notable that Section 2 does not even use the word "assent." This is not surprising, since assent is an element of *state* law governing formation of contracts, and the FAA does not displace state law with a new federal law of contracts.

"in" contracts or when they involve controversies that "arise out of" *contracts*.

One of Buckeye's *amici* does offer a textual argument from the language of the FAA. The Florida Bankers Association and the American Bankers Association ("the Bankers") argue that Congress must have intended to create a federal preemptive rule of separability, even when the principal purpose of an agreement is criminal, because Section 2 distinguishes between arbitration "provisions" and "contracts." *Amicus* Brief of the Bankers at 4-5. But the Bankers' position is inconsistent with the language of Section 2 that governs this case. The Bankers essentially would read out of Section 2 the language requiring that arbitration agreements be "in" a contract or involve controversies "arising from" a "contract." As they would rewrite Section 2, an arbitration provision or agreement would be enforceable whether or not a contract were present. This reading is contrary to this Court's "cases [that] express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment." *See, e.g., Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990). While the Bankers are correct that Congress distinguished between agreements to arbitrate and the contracts in which they are found, the Bankers disregard the relationship that Congress specified between the two. The Bankers' wish to apply the FAA to cases where there is no "contract" at all is simply at odds with the Act's language.

Buckeye's argument that federal law creates a separability principle that overrides state contract law relating to the formation of contracts also is contrary to this Court's and other courts' decisions interpreting the FAA, which provide that courts rather than arbitrators must

decide certain "gateway questions."[10] Because the existence of a "contract" is a prerequisite for the FAA to apply to an agreement, the determination is a threshold issue that must be resolved *before* a court begins to enforce the FAA. Buckeye wants courts to enforce the FAA without first establishing that the FAA applies in a case. In so arguing, Buckeye puts the cart before the horse: it demands that courts assume that an arbitration provision meets the requirements of § 2 and enforce the clause, before the court has resolved the threshold question of whether a contract exists at all.[11]

In *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002), this Court indicated that courts, rather than arbitrators, must decide basic issues relating to the existence of a contract. In *Howsam*, this Court unsurprisingly held that an arbitrator, not a court, should determine whether a party violated an arbitration rule. After all, as the Court noted, "the NASD arbitrators, comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it." *Id.*

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[10] While these decisions generally do not specify which section or language in the FAA they are applying, they must be understood as interpretations of Section 2 of the FAA because no other provision of the Act appears to relate to the issues addressed therein.

[11] One of the odder complaints in the briefs supporting Buckeye is the Chamber of Commerce's objection that the court below "assumed" that the contract is illegal. Brief for the Chamber of Commerce *et al.*, at 6. This badly mischaracterizes the result below. The court below held that a court must decide the gateway question of whether a contract exists before enforcing the arbitration provision. This is no more assuming a conclusion than it would be for a court to hold that a court – not an arbitrator – must decide the gateway question of whether there is assent to the contract in general, something that even Buckeye agrees is appropriate. Pet. Brief at 1.

at 80. There was no question that the parties were bound by a legally valid arbitration agreement in a contract, however, and this Court explained that disputes on *that* question are for the court. "[A] gateway dispute about whether the parties are bound by a given arbitration clause raises a 'question of arbitrability' for a court to decide." *Id.* at 84. This case involves just such a "gateway question."

Similarly, in *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99 (3d Cir. 2000) (Becker, J.), the court's analysis of the importance of the distinction between void and voidable contracts closely tracked the logic employed by the court below. In *Sandvik*, the court held that a party cannot enforce an arbitration clause while denying that it is bound by the contract containing that clause because, "[e]ven under the severability doctrine [of *Prima Paint*], there may be no arbitration if the agreement to arbitrate is non-existent." *Id.* at 101. The court construed *Prima Paint* as applying only to allegations that would render a contract *voidable*, and held that courts must resolve all allegations that would render an entire contract *void*:

> Mindful of the doctrine announced in *Prima Paint*, which did not consider a situation in which the *existence* of the underlying contract was at issue, we draw a distinction between contracts that are asserted to be "void" or nonexistent, as is contended here, and those that are merely "voidable," as was the contract at issue in *Prima Paint*, for purposes of evaluating whether the making of the arbitration agreement is in dispute.

Id. at 107. *See also Sphere Drake Ins. Ltd. v. All American Ins. Co*, 256 F.3d 587, 591 (7th Cir. 2001) ("Th[e dispute in

this case does not involve] a defense to enforcement, as in *Prima Paint*; it is a situation in which no contract came into being; and as arbitration depends on a valid contract an argument that the contract does not exist can't logically be resolved by the arbitrator (unless the parties agree to arbitrate this issue after the dispute arises).").

In short, not only does the language of the FAA require that a court find that a "contract" exists *before* attempting to enforce the FAA, but the decisions of this Court and other courts have recognized that it is crucial that courts resolve this "gateway" question before attempting to implement this statute.

2. Under Florida Law, an Agreement to Commit a Crime is Void *Ab Initio*, and No Part of Such an Agreement May Be Enforced.

As was just established, Section 2 requires that a contract exist before an arbitration provision in it is "enforceable." In this case, no such contract existed. The court below held that, under Florida law,[12] courts may not enforce *any* part of a contract that violates a state statute. P.A. 6a.[13] The court below rooted this holding in several

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[12] Part III.B, below, establishes that the FAA generally entrusts questions of whether a contract exists to state contract law.

[13] Many of the Florida cases dealing with illegal contracts make clear that courts will strike down the entire contract – including any and all provisions found therein – only where the "principal purpose" or the "essence" of the contract is illegal. *See, e.g., Slusher v. Greenfield*, 488 So.2d 579, 582 (Fla. Dist. Ct. App. 1986) (where illegal compensation provision related to the "one object and purpose" of employment contract, entire contract was void for illegality); *cf. United Nat'l Bank of Miami v. Airport Plaza Ltd. P'ship*, 537 So.2d 608, 610-11 (Fla. Dist. Ct.

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cases, including one that dates back more than 50 years. *Id.* (citing *Wechsler v. Novak*, 26 So.2d at 887 (1946)).

The court below easily could have quoted from scores of other Florida cases establishing these points. Florida law has long recognized, and has recognized in many different contexts, that agreements that violate Florida criminal laws and the public policy expressed in those laws are illegal and void *ab initio*, and cannot be enforced:

> The right to contract is subject to the general rule that the agreement must be legal and if either its *formation* or its performance is criminal, tortious or otherwise opposed to public policy, the contract or bargain is illegal. *See* 11 Fla. Jur. 2d, Contracts 81, Restatement of the Law, Contracts 512.... Where a statute imposes a penalty for an act, a contract founded upon said act is considered void in Florida.

Thomas v. Ratiner, 462 So.2d 1157, 1159 (Fla. Dist. Ct. App. 1984), *reh'g denied* (1985).[14] By contrast, "[i]t is

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App. 1989) (multimillion dollar real estate sale not void where illegal brokerage service term "d[id] not go to the essence" of the contract).

[14] Many of the cases relied upon by Buckeye, by contrast, assume, without citing to any authority, that illegality is not related to contract formation. In *Bess v. Check Express*, 294 F.3d 1298 (11th Cir. 2002), for example, the court acknowledged that arbitration clauses are not to be enforced when they are embedded in contracts that are void *ab initio* because one party did not have the authority to sign the contract. The court then implicitly created a new rule of federal law (in an area plainly governed by state law), that illegal contracts are subject to a different rule because the issue of illegality only goes to "the *content* of the contracts, not their *existence*." *Bess*, 294 F.3d at 1305. The *Bess* opinion never explains the rationale or cites any authority for this conclusory statement. In fact, as this section makes clear, Florida's generally applicable contract law is to the contrary. Under Florida law,

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axiomatic that fraudulent inducement renders a contract voidable, not void." *Mazzoni Farms, Inc. v. E.I. DuPont DeNemours & Co.*, 761 So.2d 306, 312 (Fla. 2000).

Under general principles of Florida contract law, the rule against the enforcement of void contracts is not a partial one that selectively invalidates parts of contracts. Instead, it is an absolute rule that invalidates void contracts in their entirety. "[I]t must be held that as a matter of law any contract made in violation of [the Act's] terms, provisions or requirements is void and confers *no enforceable rights* on the contracting parties." *Umbel v. Foodtrader.com, Inc.*, 820 So.2d 372, 374 (Fla. Dist. Ct. App. 2002) (emphasis added) (citing *Edwards v. Trulis*, 212 So.2d 893, 895 (Fla. Dist. Ct. App. 1968) and *Buehler v. LTI Int'l, Inc.*, 762 So.2d 530 (Fla. Dist. Ct. App. 2000)). *See also T.C.B. v. Florida Dep't of Children & Families*, 816 So.2d 194, 196 (Fla. Dist. Ct. App. 2002) (a contract is void as against public policy when it is injurious to the interest of the public, or contravenes some established interest of society).[15]

The Florida Supreme Court has explained the corrosive effect upon the legal system of treating an illegal

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allegations that a contract is illegal and thus void *ab initio* go to the formation of a contract in the first instance.

[15] In Florida, as in many other states, "where a statute pronounces a penalty for an act, a contract founded on such act is void, although the statute does not pronounce it void nor expressly prohibit it." *Hooten v. Lake County*, 177 So.2d 696, 701 (Fla. Dist. Ct. App. 1965); *see also Solomon v. Gilmore*, 731 A.2d 280, 289 (Conn. 1999) (citing longstanding rule articulated that "every contract made for or about any matter or thing which is prohibited and made unlawful by statute is a void contract, though the statute does not mention that it shall be so"); *Mitchell v. Smith*, 1 Binn. 110, 1804 WL 966, at *6 (Pa. 1804) (same).

contract as merely voidable, rather than void. *E.g.*, *Chandris, S.A. v. Yanakaksis*, 668 So.2d 180, 185 (Fla. 1995), *reh'g denied* (1996) (citation omitted) (treating an illegal contract as merely voidable would "afford viability to an unregulated contract of the very kind that we have determined to be in the public interest to regulate"). *See also Gonzalez v. Trujillo*, 179 So.2d 896, 897-98 (Fla. Dist. Ct. App. 1965) ("there rests upon the courts the affirmative duty of refusing to sustain that which is by the valid laws of the state, statutory or organic, has been declared repugnant to public policy. To do otherwise would be for the law to aid in its own undoing.") (citations omitted)

Under generally applicable Florida contract law, therefore, if the principal purpose of an agreement is to violate Florida's public policy as expressed in its criminal law, that agreement is void *ab initio*; no contract ever comes into existence. Accordingly, *Prima Paint* and the FAA are not helpful to Buckeye here: under normal and generally applicable principles of state contract law, this case involves the threshold question of whether a contract exists at all.

B. The FAA Entrusts the Contract Law Issues Involved Here to Generally Applicable State Laws of the Sort Applied by the Court Below.

1. Under the FAA, State Law Determines When Contracts Are Formed, as Long as It Treats Arbitration Provisions in the Same Way as Other Contract Terms.

Buckeye's argument that the FAA implicitly preempts Florida state law of contract formation fails for a second

and independent reason: the FAA creates no substantive rules of federal law governing questions of contract formation. The FAA says nothing about when a contract is or is not formed. While Congress required that an arbitration provision be "in" a "contract," it did not define the term "contract."[16] Where federal law creates no standard for a term such as "contract," there is no basis for preempting state law defining what constitutes a contract.

The Congress that enacted the FAA in 1925 obviously was aware that a substantial body of state law existed defining what was and was not a contract. If Congress had intended to define what "contracts" were for purposes of the FAA, it could have done so. Instead, the FAA simply uses the word "contract" without further elaboration. "The case for federal preemption is particularly weak where Congress has indicated its awareness of the operation of state law in a field of federal interest and has nonetheless decided to 'stand by both concepts and to tolerate whatever tension there [is] between them.'" *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 167 (1989) (quoting *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 256 (1984)).

Far from creating a federal rule that might conflict with Florida law in this case, the FAA *entrusts* states with determining the law in this area. Buckeye and its *amici* repeatedly discuss the law of arbitration in a manner as though this field is entirely governed by federal law. Nothing could be further from the truth. Instead, this

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[16] *Cf. Volt*, 489 U.S. at 474, 476 n.5 (noting absence of federal law for interpreting contracts in a setting involving "multiparty contractual disputes when some or all of the contracts at issue include agreements to arbitrate").

Court repeatedly has stressed that arbitration clauses are governed by state, not federal, contract law except in those instances where state law targets arbitration clauses for treatment that is inferior to other types of contracts. *E.g., First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995) (in cases involving the FAA, courts "should apply ordinary state-law principles that govern the formation of contracts"); *Volt*, 489 U.S. at 474 ("the interpretation of private contracts is ordinarily a question of state law"). In addition, this Court has held that principles of state contract law provide the primary source of protection for consumers against corporate over-reaching in cases governed by the FAA. *See, e.g., Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995) ("In any event, § 2 gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of any contract.' ").

This Court has recently reiterated the importance of state contract law under the FAA's scheme. In *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), a bank argued that the FAA preempted South Carolina's state contract laws as they applied to the question of whether an arbitration could proceed as a class action. This Court rejected that federal preemption argument and stated that

the question of contract interpretation is "a matter of state law. . . ." *Id.* at 447.[17]

Buckeye argues that the FAA creates a federal rule that overrides the Florida law at issue here. Buckeye's argument is contrary to this Court's decisions instructing that federal policy regarding arbitration is simply one of enforcing contracts and that the FAA merely places arbitration agreements on the same footing as other agreements. *See Prima Paint*, 388 U.S. at 404 n.12 ("the purpose of Congress [in enacting the FAA] in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so."); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219 (1985) ("The House Report accompanying the Act makes clear that its purpose was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs,' H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924).").

This principle of neutrality was central to this Court's holding in *Equal Employment Opportunity Comm'n v. Waffle House, Inc.*, 534 U.S. 279 (2002), where this Court

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[17] The Court in *Bazzle* also held that the contract interpretation question was a matter for the arbitrator to decide. This is not surprising, given that there was no dispute that the arbitration contract there was legal and binding. The Court stated that "[t]he question here . . . [does not] concern[ ] . . . the validity of the arbitration clause. . . . " 539 U.S. at 452. "Rather the relevant question here is what kind of arbitration proceeding the parties agreed to. That question does not concern a state statute or judicial procedures, . . . [i]t concerns contract interpretation and arbitration procedures. Arbitrators are well situated to answer that question." *Id.* (emphasis omitted). This case, by contrast, involves the validity of the arbitration clause (because the provision here does not meet Section 2's requirement that it be in a "contract" or relate to a controversy that arises out of a "contract"). Also, unlike *Bazzle*, this case involves a number of state statutes.

refused to enforce an arbitration provision in an employment contract in a case where claims were asserted by a federal agency that was not a party to that contract. In *Waffle House*, the lower court had effectively treated arbitration clauses as some sort of super contract especially favored under federal law. This Court rejected the notion that the FAA embodied a policy goal that would form arbitration agreements in circumstances where no other type of contract could be formed. *Id.* at 280. Instead, this Court directed, the FAA requires courts to place arbitration agreements on equal footing with other contracts, but it "does not require parties to arbitrate when they have not agreed to do so." *Id.* (quoting *Volt*, 489 U.S. at 478). *See also Doctor's Assoc., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (holding that the FAA preempted a state statute that imposed specific disclosure requirements applicable only to arbitration agreements; and echoing the Court's earlier decisions in explaining that, through the FAA, Congress precluded states from singling out arbitration provisions for suspect treatment, requiring instead that such provisions be placed upon the same footing as other contracts). The Court summarized the governing principle in *Dobson*, 513 U.S. at 281:

> States may regulate contracts, including arbitration clauses, under general contract law principles. . . . What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal footing, directly contrary to the Act's language and Congress' intent.

The neutrality principle recognized in these cases prevents states from undermining the FAA's purpose of placing arbitration agreements on the same footing as other contractual provisions. Ironically, Buckeye's arguments here would undermine the FAA's purpose by placing a thumb on the contract law scale in favor of arbitration in circumstances where no other contract provision could be enforced. The Court should reject these arguments as contrary to the purposes of the FAA itself.

2. The Florida Contract Law Applied Below Applies to All Contracts and Is Consistent With the Contract Law of Many Jurisdictions.

Buckeye's attempt to extend *Prima Paint* here also is untenable because the Florida State law relied upon by the court below is applicable to the formation of all contracts, and therefore is fully in keeping with the FAA. Buckeye and its *amici* allege that the decision below arises from a hostility to arbitration. *E.g.*, Pet. Br. at 2. This charge is palpably untrue: the decision of the court below arises from basic rules of Florida state contract law that date back many years, and that have been applied repeatedly in settings that have nothing to do with arbitration. For example, *Thomas v. Ratiner*, 462 So.2d at 1158, which established that, if a contract is criminal, it is void under Florida law, did not arise in an agreement to arbitrate, and instead involved the enforcement of a lawyer's retainer agreement. Similarly, *Umbel v. Foodtrader.com*, 820 So.2d at 373, which established that illegal contracts give rise to no enforceable rights, did not involve an agreement to arbitrate, but rather whether a partnership agreement violated state securities laws. *Gonzalez v.*

Trujillo, 179 So.2d at 898, which held that Florida courts have an affirmative duty not to enforce illegal contracts, involved a contract to pay a refugee to bring assets out of Cuba. Even Buckeye recognizes that the decision of the court below on Florida contract law is consistent with the statement of law contained in a Florida legal encyclopedia. Pet. Br. at 11.

This Court also should be very reluctant to find that federal law preempts the decision of the court below because the principles of Florida contract law identified in the decision below are black-letter law in many other jurisdictions. This Court would be overriding not only Florida law on these issues, but also overriding standard principles of contract law recognized by a great many courts and other authorities throughout the nation for many years.

Many courts have recognized, for example, the following propositions embedded in the decision below: (1) agreements that are void *ab initio* never form "contracts"; (2) there is a significant difference between contracts that are void *ab initio* and those that are merely voidable; (3) agreements that violate statutes are void *ab initio*; and (4) where the principal purpose of an agreement is illegal, courts recognize an anti-separability principle and will enforce no provision of the contract.

First, most authorities acknowledge the general principle relied upon by the court below that an agreement that is void *ab initio* is one that "has at no time had any legal validity." Black's Law Dictionary (6th ed. 1991); *see also* Corbin on Contracts, § 1.7, at 20 (rev. ed. 1983) ("In the term 'void contract' there is self-contradiction. This is because the term 'contract' is always defined so as to

include some element of legal enforceability."). If something is "void," it has "total absence of legal effect." *Id.; see also* Restatement of Contracts (Second) § 7, comment (1981) ("Second Restatement") (a "void contract . . . is not a contract at all").

Second, the new preemptive rule advanced by Buckeye would overturn longstanding decisions recognizing a significant distinction between agreements that are void *ab initio* and those that are merely voidable. *See, e.g., Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U.S. 24, 59 (1891) (explaining that a contract of a corporation that exceeds the powers conferred on it by the state legislature "is not voidable only, but wholly void, and of no legal effect. The objection to the contract is not merely that the corporation ought not to have made it, but that it *could not* make it.") (emphasis added); *Langley v. FDIC*, 484 U.S. 86, 93-94 (1987) (recognizing as decisive a distinction between void contracts and merely voidable contracts, such as those where conduct "constitute[s] only fraud in the inducement"); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 387 (1970) (statute read as making certain contracts "voidable," rather than "void" (in which case it would "compel the conclusion that the contract is a nullity"), in order to avoid imposing harm upon innocent plaintiffs); *Still v. Norfolk & W. Ry. Co.*, 368 U.S. 35, 40-41 (1961) (there is a "normal distinction between 'void' and 'voidable' contracts"); *Twin-Lick Oil Co. v. Marbury*, 91 U.S. 587, 589 (1875) (setting forth the distinction between "absolutely void," or "void *ab initio*" contracts, and those that are "voidable"; holding that a purchase may be ratified where it was merely voidable).

Third, notwithstanding Buckeye's call for a new federal preemptive rule to the contrary, the principle that

a contract prohibited by statute can never be validly formed is also a widely accepted rule of contract law throughout the nation. *See, e.g.*, *In re Donnay*, 184 B.R. 767, 784-85 (Bkrtcy. D. Minn. 1995) ("A void contract is no contract at all; it binds no one and is a mere nullity. Thus, an action cannot be maintained on the contract, nor can the contract later be validated. . . . [I]f the contracts in this case are deemed usurious [under Minnesota law], they in essence *never existed*.") (emphasis added); *Solomon v. Gilmore*, 731 A.2d 280, 289 (Conn. 1999) ("every contract made for or about any matter or thing which is prohibited and made unlawful by statute is a void contract"); *Illinois State Bar Ass'n Mutual Ins. Co. v. Coregis Ins. Co.*, 821 N.E. 2d 706 (Ill. Ct. App. 2004) ("[I]if the subject matter of the contract is illegal, that contract is void *ab initio*."); *Fowler v. Scully*, 72 Pa. 456, 1872 WL 11551, at *9 (Pa. 1872) ("a contract in violation of the provisions of a statute . . . is null").

Fourth, contrary to Buckeye's insistence on a federal rule of separability in all contexts, many jurisdictions have embraced a principle of non-separability for illegal contracts: where the principal purpose of an agreement is illegal, courts will enforce no part of it. In *McMullen v. Hoffman*, 174 U.S. 639, 654 (1899), this Court considered a proposal akin to what Buckeye urges here: that the Court isolate and enforce one provision of a contract of which the principal purpose was illegal – in that case, a partnership provision of an agreement between two nominal competitors to secretly submit fictitious construction bids. This Court rejected the argument that the term was enforceable:

> [T]he plaintiff . . . cannot refer to one portion only of the contract upon which he proposes to

> found his right of action, but that the whole of the contract must come in, although the portion upon which he founds his cause of action may be legal.

Id. at 656; *see also Evans v. Jeff D.*, 475 U.S. 717, 727 n.13 (1986) ("If the performance as to which the agreement is unenforceable as against public policy is an essential part of the agreed exchange, . . . the *entire* agreement is unenforceable.") (quoting Second Restatement § 184 (internal quotations and parentheses omitted, emphasis added)); *Hargrave v. Canadian Valley Elec. Coop.*, 792 P.2d 50, 60 (Okla. 1990) ("If the invalid contractual provision is an essential part of the agreement and the parties would not have agreed absent that provision, then the *entire* contract is unenforceable.") (emphasis added); *Santa Clara Valley M. & L. Co. v. Hayes*, 18 P. 391, 393 (Cal. 1888) (where "the very *essence* and *mainspring* of the agreement" is illegal, "it cannot be separated, and leave any subject-matter capable of enforcement.") (emphasis added).

While Buckeye asks this Court to read the FAA to preempt the rule of non-separability for illegal contracts recognized by the court below, this non-separability principle is rooted in at least two fundamental policies of contract law that have been recognized by numerous courts around the country. First, to enforce a right arising from an illegal contract is to reward, and thus to encourage, unlawful – and in some cases criminal – behavior. Thus, it is black-letter law that "one who has participated in a violation of the law will not be allowed to assert in court any right based upon or directly connected with the illegal transaction." Williston on Contracts § 12:4, p. 24 (rev. ed. 1995).

Second, many courts have held that the integrity of the courts themselves would be compromised by the judicial sanction of unlawful contracts. This Court has said:

> [N]o court of justice can in its nature be made the handmaid of iniquity. Courts are instituted to carry into effect the laws of a country, how can they then become auxiliary to the consummation of violations of the law?

Bank of the U.S. v. Owens, 27 U.S. 527, 1829 WL 3157, at *9 (1829); *see also Armstrong v. Toler*, 24 U.S. 258, 264 (1826) ("[W]here contract . . . is connected with[ ] an illegal or immoral act, a Court of justice will not lend its aid to enforce it. . . . "); *Coppell v. Hall*, 74 U.S. 542, 559 (1868) ("the law will not lend its support to a claim founded on its violation."); *Hunt's Heirs v. Robinson's Heirs*, 1 Tex. 748, 1847 WL 3502, at *7 (Tex. 1847) ("Courts are organized under the law and are required to administer it, and it would seem to be an anomaly were they so far to sanction its violation as to give effect to a contract forbidden by the very law that they are bound to respect and enforce."); *Jamieson v. Iles*, 219 Ill. App. 432, 1920 WL 1231 at *8 (Ill. Ct. App. 1920) (courts refuse to enforce illegal contracts "not on account of any solicitude for the parties, but as a duty they owe the cause of justice and the integrity of its courts"); *Bank of the South v. Korner*, 323 So.2d 197 (La. Ct. App. 1975) ("We simply are unwilling to allow the courts to be used to enforce contracts with an illegal purpose. . . . [T]he contract, which bargained for the performance of an illegal act [has] no existence in law."); *Fowler*, 1872 WL 11551 at *10 ("[O]ur courts will not lend their aid to enforce illegal contracts. . . . The contract is illegal, being founded on a breach of the law, and of

consequence is a void contract and cannot be enforced in a court of law. . . . [C]ourts of justice will not assist an illegal transaction in any respect.") (internal citations and quotations omitted).

In short, the decision of the court below is hardly rooted in some anti-arbitration animus, but instead arises from a long-standing and nationally accepted wellspring of wisdom about the formation of contracts. This Court should reject Buckeye's invitation to invent a new rule of federal law that would override this history.

IV. PUBLIC POLICY SUPPORTS THE DECISION BELOW.

A. Buckeye's Proposed Extension of *Prima Paint* Would Lead to Absurd Results.

The state law principles applied by the court below are not only widely accepted and venerable, they also make good sense. Buckeye's argument that they are preempted by a federal rule that arbitration clauses are exempt from this well-established body of law could readily lead to absurd results. Imagine hypothetical agreements providing for the sale of cocaine, or the making of child pornography, or a murder-for-hire, that include (a) a liquidated damages provision; and (b) an arbitration agreement. In these hypotheticals, the principal purpose of the agreements is to violate criminal laws, and the liquidated damages and arbitration provisions are subsidiary provisions, filling in details relating to implementation of the criminal agreement.

The response of the court below to these hypotheticals is clear: under normal principles of Florida contract law, these agreements are void *ab initio*, and the court must

disregard them in their entirety. No part of any such agreement constitutes a "contract" under Florida law.

Under Buckeye's reasoning, however, Florida state courts must enforce the arbitration clauses, but not the liquidated damages provisions, in these hypothetical agreements. That cannot be so, and surely cannot be what the FAA requires. Buckeye suggests that there is no harm in this result, because courts can assume that any arbitrator will hold that the sale of cocaine, making of child pornography or murder is illegal. Pet. Br. at 17-18. But Buckeye provides no reason why Congress would want this result, much less impose it on every state court.

Buckeye's response to these hypotheticals also ignores the traditional reasoning that underlies the state laws relating to illegal contracts. As set forth above, the Florida contract law that criminal contracts are void *ab initio* in their entirety (which is reflected in the law in a number of other jurisdictions as well) arises from a need to protect the courts themselves as institutions: it would be corrosive of a court's authority and dignity to enforce even a part of a murder-for-hire contract. The assertion that federal law requiring the enforcement of an arbitration provision in a "contract" requires courts to recognize and enforce provisions in a criminal agreement is offensive and absurd.

Buckeye's response to this hypothetical also fails in light of this Court's direction that arbitration provisions are to be as enforceable – but no more so – as other types of contract provisions. By insisting that an arbitration clause in an agreement for the sale of cocaine is enforceable (but not the rest of the agreement), Buckeye is asking this Court to create a rule of law that makes arbitration clauses more enforceable than all other types of contracts.

It is obvious, for example, that no Florida court (and probably no other court) would – or should – ever enforce a liquidated damages provision contained in a contract for the sale of cocaine or the making of child pornography. Even though liquidated damages provisions (like arbitration provisions under the FAA) are normally enforceable and favored, because a criminal agreement is void *ab initio*, the entire agreement – including *all* of the provisions found therein – would be unenforceable. Under the position advocated by Buckeye, however, the arbitration clause would somehow be different from and better than all other provisions in this wholly illegal contract, and the arbitration clause would be enforced.

B. The Policy Arguments of Buckeye and Its *Amici* Are Irrelevant, Exaggerated and Unpersuasive.

Instead of recognizing the dangers in their approach, Buckeye and its *amici* make a number of heated policy arguments to support the preemption of Florida law in this case. These arguments generally fall into two categories. First, Buckeye and its *amici* argue that the FAA embodies an urgent policy in favor of arbitration. As Buckeye and its allies conceive of this policy, it is not the one expressed in the language of the statute – that arbitration provisions are to be enforced if they are "in" contracts or if they involve controversies that "arise out of" contracts, subject to generally applicable contract law – but it is a broader mandate to remove as many cases as possible from courts and to move them into arbitration. Buckeye and its allies go further to argue that the affirmance of the opinion of the court below will undermine the enforcement of arbitration clauses in a large number of

cases. *E.g.*, Pet. Br. 20 ("Virtually all contracts can be challenged as illegal.") Second, several of Buckeye's *amici* ask this Court to believe that the payday lending industry is a wonderful boon to the nation's poor, and that any state laws that might regulate it are misguided. These policy arguments are wrong and unpersuasive on several levels.

First, policy arguments cannot justify a refusal to follow the language of the FAA itself. Even if one assumes for the purposes of argument that it was unwise for Congress to draft the FAA in a way that requires that arbitration agreements be in a contract or involve controversies arising out of a contract to fall within the Act, or even if one assumes for the purposes of argument that it was not wise for Congress to limit the reach of §§ 3 and 4 to the federal courts, this Court is not free to embrace Buckeye's arguments. *See, e.g., Brogan v. United States*, 522 U.S. 398, 408 (1998) ("Courts may not create their own limitations on legislation, no matter how alluring the policy arguments for doing so. . . . ").

Similarly, any policy arguments of the payday lending industry about its supposed economic merits are not addressed to the proper forum.[18] If Buckeye's *amici* are right in their policy prescriptions, that is an argument that states should repeal their criminal loan sharking laws or exempt payday lenders from those laws, not that this

[18] While this brief will not focus in detail on those arguments, some of them are rather curious. The industry's main evidence as to its societal value is to survey persons who are in the process of obtaining payday loans and ask them if they are satisfied to receive the loans. *E.g., Amicus* Br. of the CFSA at 4-5. One wonders how many customers of even the worst and most predatory loan sharks in America's history would have answered such a question from an agent of the loan shark, immediately after receiving a loan, in the negative.

Court may wipe away those state statutes without a plain statement from Congress calling for such preemption.

Buckeye employs a great deal of high-octane rhetoric to argue that the entire structure of the FAA will come undone if courts rather than arbitrators decide whether contracts are illegal. This argument ignores the unique nature of the allegations in this case. Civil plaintiffs regularly argue that some particular conduct of a defendant breaches a contract or gives rise to a remedy under some remedial statute, but it is quite rare to encounter a civil plaintiff arguing that an entire line of business is prohibited by a statute and is per se illegal. It is particularly rare to see a case, such as this, where there are substantive arguments that the entire enterprise is *criminal*. A ruling for Plaintiffs will have no effect upon traditional banks, or any other legitimate business enterprise. A ruling for Plaintiffs here will only affect businesses whose contracts are wholly illegal, such as the Defendants here, or the cocaine sellers hypothesized above. The ruling of the court below is highly unlikely, as a practical matter, to be applicable in many cases.

Buckeye and some of its *amici* complain that the Florida Supreme Court used overly broad language to phrase its holding, when it held that a contract could not be enforced where it violates "public policy." *E.g.*, Pet. Br. 21. That phrase must be understood in the context of this case: the state's public policy forbidding the contract at issue *here* is expressed through the state's criminal statutes. This case is not about some mild policy preferences of individual judges; it is about the civil legal implications of criminal conduct. As set forth in the Statement of the

Case, Plaintiffs have alleged that the mere act of entering the agreements at issue here is a felony;[19] under Florida Law, the agreement documents themselves are "contraband," and a Florida statute specifically provides that loan sharking agreements are unenforceable. Notwithstanding the "sky is falling" rhetoric of Buckeye, this case involves a very narrow fact pattern that is not likely to recur regularly in commercial settings.

Buckeye's final policy argument is equally unpersuasive. It argues that this Court should override the generally applicable law of contract formation (except as it relates to assent), because there is a great need for federal law to create nationwide uniformity in the laws relating to the formation of contracts containing arbitration agreements. This argument fails for three reasons. First, courts may not preempt state laws merely because parties make rote assertions that uniformity is needed. *See, e.g., Bates*, 125 S. Ct. at 1802-03 ("Dow and the United States exaggerate the disruptive effects of using common-law suits to enforce the prohibition on misbranding. . . . We have been pointed to no evidence that such tort suits led to a 'crazy-quilt' of FIFRA standards or otherwise created any real hardship for manufacturers or for EPA.") Second, as this Court has made clear in other preemption cases, there is little need for uniform federal law here, because the law of contracts is largely consistent from state to state. *See American Airlines v. Wolens*, 513 U.S.

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[19] The payday lenders' trade association scoffs at this notion. *See Amicus* Brief of the CFSA at 3. There is, however, no federal law basis for this Court to second guess or override a state legislature's judgment that if a lender (that is not a national bank) charges interest rates of up to 1,300%, this act is criminal loan sharking.

219, 232 n.8 (1995) ("contract law is not at its core 'diverse, nonuniform, and confusing'"), quoting *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 529 (1992). Third, even if nationwide uniformity of contract law were desirable, that could not justify rewriting the FAA's statutory scheme. Where, as here, a statute preserves a role for states, that reflects a congressional intention to accept some degree of disuniformity. *Cf. UNUM Ins. Co. of Am. v. Ward*, 526 U.S. 358, 376 n.9 (1999) (disuniform state regulations "are the inevitable result of the congressional decision [in ERISA] to save local insurance regulation.")

In short, if this Court finds that the FAA does not preempt normal principles of contract law in this case, that holding will hardly undermine the widespread enforcement of arbitration agreements in most circumstances. Buckeye's policy arguments to the contrary are misplaced and greatly exaggerated.

CONCLUSION

For the reasons set forth above, this Court should affirm the decision of the Florida Supreme Court.

Respectfully submitted,

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Supreme Court, U.S.
FILED
AUG 12 2005
OFFICE OF THE CLERK

(5)

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ of Certiorari
to the Supreme Court of Florida

BRIEF OF *AMICI CURIAE* FLORIDA BANKERS ASSOCIATION AND AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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INTEREST OF *AMICI CURIAE*[1]

Amicus curiae Florida Bankers Association ("FBA") is a voluntary organization of financial institutions doing business in the State of Florida. FBA regularly represents the interests of its members before all branches of government and frequently appears as an *amicus curiae* in the state and federal courts, including, on several occasions, before this Court. The issue in this case is of particular importance to FBA and

[1] This brief is filed with the written consent of all parties. No counsel for a party authored this brief in whole or in part, nor did any person or entity, other than *amici* or their counsel, make a monetary contribution to the preparation or submission of this brief.

its members because arbitration agreements are a significant way in which FBA members attempt to promote the efficient and inexpensive resolution of disputes. By undermining the application and enforceability of arbitration clauses, the decision below, if allowed to stand, will impose greater costs and greater uncertainty upon FBA's members.

Amicus curiae American Bankers Association ("ABA") is the principal national trade association of the banking industry in the United States. ABA has members in each of the fifty states and the District of Columbia. ABA member banks hold approximately 90% of the domestic assets of the banking industry in the United States. ABA frequently appears in litigation as a party or *amicus* where issues raised in a case are of widespread importance and concern to the industry. The issue in this case is of precisely such importance and concern to the banking industry because the decision below and others like it threaten to undermine the tremendous benefits of arbitration agreements used in the banking industry and to divert numerous disputes into the more expensive and less efficient court system.

SUMMARY OF ARGUMENT

1. The proper approach to assessing the making and validity of arbitration clauses is to treat them as separable or severable contracts that must be analyzed independently from the validity of the contracts with which they are associated. Both the language of the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1, *et seq.*, and this Court's decision in *Prima Paint Corp.* v. *Flood & Conklin Manufacturing. Co.*, 388 U.S. 395 (1967), support such an independent analytical approach. The sole question for the courts is whether the parties have made a valid agreement to arbitrate, regardless whether the remainder of the parties' agreements are valid or enforceable. Numerous federal courts of appeals have correctly adopted a "doctrine of separability" to distinguish between claims that necessarily bear upon the validity of the arbitration agreement

and claims going to the validity of the substantive contract but that have no intrinsic effect on the arbitration agreement.

That analytical approach is the best and most efficient tool to help courts properly answer the question whether an arbitration agreement survives a claim that the underlying contract is void or voidable. Using such an approach, the claim below – that the contract is substantively void based on an alleged violation of usury laws – has no inherent bearing on the separate agreement to arbitrate and hence the claim should be heard by an arbitrator, not a court. The decision below, however, conflated the issue of underlying contractual validity and arbitration-agreement validity by holding that no part of a void agreement is severable. That holding is directly contrary to the federal rule that arbitration agreements are to be treated as separable contracts and hence should be reversed.

2. The expansive, efficient, and certain enforcement of arbitration agreements is of substantial importance to the banking and other industries and is a worthy goal long established and supported by Congress and this Court. Arbitration agreements are used extensively throughout the banking and other industries and the prospective adverse consequences of the decision below are significant and widespread. The particular issue in this case – whether claims of contract invalidity not independently applicable to the arbitration agreement are to be decided by the court or the arbitrator – likewise arises in connection with numerous contracts, based on many different claims of illegality. Shifting such a broad swath of claims into the courts and away from arbitration thus would severely undermine the goals of the FAA to the detriment of the banking industry, their customers, and all other contracting parties who benefit from the efficiency, expertise, and lower expenses of arbitration.

ARGUMENT

I. ARBITRATION CLAUSES MUST BE TREATED AS SEPARABLE OR SEVERABLE CONTRACTS, THE VALIDITY OF WHICH IS DETERMINED INDEPENDENTLY FROM THE SUBSTANTIVE VALIDITY OF THE UNDERLYING AGREEMENTS.

The question posed in this case is whether the alleged invalidity of a contract in general likewise invalidates an arbitration clause contained therein where the invalidity stems from some substantive defect in other parts of the contract that does not independently apply to the arbitration clause itself. That question is effectively answered by both the FAA and this Court's decision in *Prima Paint*, which treat an arbitration clause as a *separable* agreement not affected by alleged deficiencies that do not independently relate to the arbitration agreement itself. The Florida Supreme Court held otherwise and concluded pursuant to *state* law that an otherwise valid arbitration clause was not severable from the allegedly void terms of the underlying contract and hence was void by mere association. That holding was error and should be reversed.

As a matter of federal law, arbitration clauses are deemed to be separate and severable agreements from the underlying contracts in which they may appear. The basis for such separability can be found both in the statute and in this Court's cases. Section 2 of the FAA, for example, provides in relevant part that a "written *provision* in any * * * contract * * * to settle by arbitration a controversy thereafter arising out of such contract * * * *shall be valid*, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (emphasis added). The statute thus expressly distinguishes between a "provision" for arbitration and the "contract" in which it may be contained, and specifies the validity, etc., of such provision

without mention of or regard for the validity of the contract as a whole. Similar separation of the arbitration clause from the contract as a whole appears in other sections of the FAA as well. *See, e.g.*, 9 U.S.C. § 4 (providing for an order directing arbitration upon the court "being satisfied that the making of *the agreement for arbitration* * * * is not in issue," without regard for whether the making of any underlying contract in general is in issue) (emphasis added). By creating a distinct federal rule applicable only to the "provision" or "the agreement for arbitration," the statute necessarily creates a separation between consideration of the agreement as to forum and the substance of disputes to be resolved by that forum.

This Court in *Prima Paint* applied just such a separability analysis to reject a claim that alleged fraud in the inducement of the contract generally somehow undermined a non-fraudulently induced agreement to arbitrate issues arising out of that contract. After describing the split between the Second and First Circuits over whether an arbitration agreement's separability or severability was a matter of federal or state law, this Court concluded that "Congress has provided an explicit answer": The "making" of an agreement to arbitrate is to be analyzed independently from the underlying contract. 388 U.S. at 403. "If the claim is fraud in the inducement of the arbitration clause itself," a court may resolve it; but if the claim goes to "the contract in general," it is an issue for the arbitrator. *Id.* at 403-04. This Court reiterated such separate treatment by concluding that a court "may consider *only* issues relating to the making and performance of the agreement to arbitrate." *Id.* at 404 (emphasis added).

Numerous federal Courts of Appeals, both before and since *Prima Paint*, have correctly followed the federal-law requirement that agreements to arbitrate be analyzed independently from the underlying contract.

Perhaps the most illustrative early case comes from the Second Circuit and is the very case with which this Court sided in resolving the split that led to *Prima Paint*. In *Robert*

Lawrence Co. v. *Devonshire Fabrics, Inc.*, 271 F.2d 402 (CA2 1959), *cert. granted*, 362 U.S. 909, *dismissed under Rule 60*, 364 U.S. 801 (1960), the Second Circuit rejected a claim that fraud in the inducement of the contract generally would likewise undermine the associated arbitration clause that was not itself fraudulently induced. Relying on the terms of the statute, the Court explained:

> That the Arbitration Act envisages a distinction between the entire contract between the parties on the one hand and the arbitration clause of the contract on the other is plain on the face of the statute. Section 2 does not purport to affect the contract as a whole. On the contrary, it makes "valid, irrevocable, and enforceable" only a "written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction" * * *.

271 F.2d at 409-10.

That same distinction carries through to the grounds on which an agreement to arbitrate *can* be challenged. Under the exception in Section 2 of the FAA, a written provision or agreement to arbitrate is valid, irrevocable, and enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Just as the basic validity described in Section 2 is limited to the arbitration agreement itself, so too is the exception:

> The agreement described in Section 2 is the arbitration "provision" or clause of the principal contract. If this arbitration clause was induced by fraud, there can be no arbitration; and if the party charging this fraud shows there is substance to his charge, there must be a judicial trial of that question before a stay can issue.

271 F.2d at 410-11.

Finally, the Second Circuit went on to observe that its treatment of "the agreement to arbitrate as a separable part of

the contract is based not only upon the clear wording of the text [of § 2 of the FAA] but is buttressed by several other pertinent considerations" including the historical treatment of arbitration clauses "as separable parts of the contract." *Id.* at 410 (citing cases). Such separability is further reinforced by the fact that "the mutual promises to arbitrate would form the *quid pro quo* of one another," *id.* at 411, which creates independent consideration for a bilateral agreement to arbitrate.[2] (Interestingly, many arbitration clauses, including the one in this case, are also supported by separate signatures as well. JA 36, 38, 40, 42.)

Following *Prima Paint* and *Robert Lawrence*, other Circuits have likewise adopted and applied the separability principle to preserve arbitration clauses in the face of alleged invalidity based on unrelated defects in other elements of the parties' substantive agreements. *See, e.g.*, *Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 880-82 (CA11 2005) (applying *Prima Paint* rule to claim of substantive voidness based on Georgia statute); *Fazio* v. *Lehman Bros., Inc.*, 340 F.3d 386, 394-95 (CA6 2003) (focusing "on the validity of the arbitration clauses standing alone" in the face of claimed theft of funds allegedly voiding underlying brokerage account agreements); *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631, 636-38 (CA4) (applying "severability doctrine" to reject challenge to arbitration based on alleged voidness due to claimed violation of state usury and licensing laws), *cert. denied*, 537 U.S. 1087 (2002); *Burden* v. *Check Into Cash of Ky., LLC*, 267 F.3d 483, 489-90 (CA6 2001) (same), *cert. denied*, 535 U.S. 970 (2002); *Harter* v. *Iowa Grain Co.*, 220 F.3d 544, 550 (CA7 2000) (applying *Prima Paint* to re-

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[2] That a bilateral agreement to arbitrate forms its own consideration helps explain why fraudulent inducement regarding other aspects of the contract – effectively a deficiency in consideration – has no inherent bearing on the agreement to arbitrate. A unilateral agreement to arbitrate, not supported by its own built-in consideration, would likely fare differently under the separability analysis.

ject challenge to arbitration based on underlying contract's alleged violation of Commodities Exchange Act); *3H & Assocs., Inc.* v. *Hanjin Eng'g & Constr. Co.*, No. 97-16751, 1998 WL 657722, at *2 (CA9 1998) (unpublished) (applying *Prima Paint* to reject challenge to arbitration based on claim that construction contract was void in requiring building code violations); *National R.R. Passenger Corp.* v. *Consolidated Rail Corp.*, 892 F.2d 1066, 1070 (CADC 1990) (rejecting challenge to arbitration based on alleged voidness of underlying agreement's inconsistency with public policy regarding safety); *Lawrence* v. *Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1161-62 (CA5 1987) (applying *Prima Paint* to reject challenge to arbitration based on alleged voidness of underlying contract due to violation of Texas statute).[3]

Not only is the separability doctrine a correct reading of the FAA and this Court's precedents, it also is a clear and easily applied analytical approach to reviewing the "making" of arbitration agreements and thus fulfills the underlying purpose of the FAA to make the enforcement of arbitration agreements speedy and effective. *See infra*, Part II. Rather than get caught up in irrelevant, shifting, and often esoteric disputes over whether a challenge would render a contract void or voidable, or whether a challenge goes to the contract as a whole, the separability approach merely requires treating an arbitration provision as a discrete entity and asking whether the challenge still logically applies on its own terms. If the challenge *does* still apply then a court must resolve it,

[3] And, while not expressly addressing the issue here, this Court has implicitly applied the separability doctrine in holding that the alleged illegality of the underlying transaction does not negate an agreement to arbitrate disputes arising from that transaction. *See Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 239-40 (1987) (arbitration not precluded by claims alleging criminal violations of Securities laws and RICO); *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985) (arbitration not precluded by claims alleging violations of the antitrust laws).

regardless whether the outcome would be voidness or mere voidability and regardless whether the challenge would *also* affect the validity of the contract as a whole. But where the challenge has no inherent application to a separate arbitration agreement, it would be for the arbitrator to resolve if the challenge fell within the scope of the arbitration clause.

Separability analysis thus would make short and efficient work of deciding who should resolve the various challenges to arbitration. For example, a claim that a party never signed the agreement at all, or that his signature was forged, independently challenges the making of the arbitration agreement and would be a proper challenge to arbitration regardless of what the remainder of the contract said. *Opals on Ice Lingerie* v. *Body Lines, Inc.*, 320 F.3d 362, 370 (CA2 2003) (signature forged); *Chastain* v. *Robinson-Humphrey Co.*, 957 F.2d 851, 855 (CA11 1992) (party had not signed agreement at all). While such a claim would *also* challenge the validity of the contract as a whole, it is its independent effect on the agreement to arbitrate that matters and acts as a judicially cognizable deficiency even after severance of the arbitration agreement from the remainder of the contract. The point is not that a claim must apply *only* to the arbitration clause, but rather that it must apply *independently* to the arbitration clause.[4]

[4] This approach also would resolve the confusion of some courts that have questionably refused to consider challenges to arbitration clauses because such challenges were not *unique* to the arbitration clause but also applied to the remainder of the contract. *Compare Primerica Life Ins. Co.* v. *Brown*, 304 F.3d 469, 472 (CA5 2002) (dubiously refusing to consider a lack-of-mental-capacity defense to an arbitration agreement because it was also a defense to the entire agreement) *with Spahr* v. *Secco*, 330 F.3d 1266, 1273 (CA10 2003) (correctly holding that "mental capacity defense naturally goes to *both* the entire contract and the specific agreement to arbitrate" and thus was for the court do decide as it applied to the arbitration agreement) (emphasis in original). As explained, it is the *independant* application of a challenge to the arbitration clause that determines

Other likely examples of claims that would apply even to separable agreements to arbitrate include claims involving questions of authority on the part of a supposed agent, the issue of capacity of the signatory (as in the cases of children or incompetents), certain issues of offer and acceptance that might rebut the notion that the parties ever reached agreement in the first place, or even a possible failure of consideration if the agreement to arbitrate were unilateral rather than bilateral. *See, e.g.*, *Spahr* v. *Secco*, 330 F.3d 1266, 1273 (CA10 2003) (lack of mental capacity); *Sphere Drake Ins. Ltd.* v. *All Am. Ins. Co.*, 256 F.3d 587, 591 (CA7 2001) (agent lacked authority to sign); *Three Valleys Municipal Water Dist.* v. *E.F. Hutton & Co.*, 925 F.2d 1136, 1139-42 (CA9 1991) (agent lacked authority to sign); *see also Will-Drill Resources, Inc.* v. *Samson Resources Co.*, 352 F.3d 211, 219 (CA5 2003) (giving example of a failure of offer and acceptance meaning no agreement to arbitrate was ever formed).

A separate arbitration agreement, however, would *not* be subject to a claim of *usury* or other illegality unrelated to the arbitration clause itself. *See, e.g.*, *Fazio*, 340 F.3d at 394-95 (alleged RICO and securities laws violations); *Bess* v. *Check Express*, 294 F.3d 1298, 1304-06 (CA11 2002) (alleged usury and lack of licenses); *Harter*, 220 F.3d at 550 (alleged Commodities Exchange Act violation); *Lawrence*, 833 F.2d at 1161-62 (alleged violation of Texas statute). Where validity turns on some *substantive* defect in the terms or performance of the other parts of the contract, separating out the challenged portion of the contract would indeed leave a valid arbitration agreement. Where the arbitration clause is independently valid, but the remainder of the contract is in doubt, the validity of the rest of the contract can and must be resolved by the arbitrator.

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judicial cognizability, not its *exclusive* application to the arbitration clause.

Correctly understood and applied, the federal requirement of separability renders the Florida Supreme Court's void/voidable distinction wholly irrelevant. The issue is not the *effect* of the alleged defect in a contract, but rather whether such defect applies *independently* to the arbitration clause itself. If the arbitration clause *itself* is alleged to be fraudulently induced, and hence merely voidable, that issue would still be for the courts rather than an arbitrator. *Prima Paint*, 388 U.S. 403-04. Such a claim applies independently to the arbitration clause and is not diminished by any unrelated distinctions between claims of voidness or voidability. Likewise, where a particular claim does *not* independently apply to the arbitration clause, its effect is not strengthened by its involving voidness rather than voidability. In this case, because an alleged violation of the usury laws is based exclusively on the separate substantive provisions of the underlying contract, and has no *independent* application to the arbitration clause itself, it cannot have any effect on the separable agreement to arbitrate regardless of its effect on the remainder of the contract.

II. EXPANSIVE AND CERTAIN ENFORCEMENT OF ARBITRATION AGREEMENTS FURTHERS THE VALUABLE AND ESTABLISHED PURPOSES OF THE FAA.

The erroneous approach of the Florida Supreme Court is particularly troubling because of the extensive impact such an approach would have on arbitration and the ensuing damage it would cause to federal policy favoring arbitration. Arbitration agreements appear in a wide variety of contracts in the banking and other industries. Those underlying contracts are often the target of claims of illegality having nothing to do with the arbitration clauses themselves but that, under the decision below, would effectively nullify numerous agreements to arbitrate.

A. The Decision Below Would Exclude a Broad Swath of Claims from Arbitration.

As this Court is certainly well aware, arbitration clauses appear in an extensive array of contracts involving a myriad of goods and services. In the banking industry, in particular, arbitration clauses are an often used and often litigated element of contracts. *See, e.g.*, *Green Tree Financial Corp.* v. *Bazzle*, 539 U.S. 444, 447 (2003) (home improvement loan agreement); *Citizens Bank* v. *Alafabco, Inc.*, 539 U.S. 52, 53 (2003) (commercial construction debt restructuring agreement); *Green Tree Financial Corp.-Alabama* v. *Randolph*, 531 U.S. 79, 82 (2000) (mobile home financing and insurance agreement).

Arbitration clauses appear in savings and checking account agreements, home loan agreements, auto loan agreements, personal loan agreements, credit card agreements, and various ancillary investment and other agreements entered into between banks and consumers. In one study of consumer-initiated arbitration, for example, 90% of the arbitrations reviewed were related to consumer lending in one form or another, and of those arbitrations, 75.2% were related to the banking industry, including claims regarding insurance linked to credit cards, savings and checking account transaction disputes, disputes over credit card charges, interest rates and payments, mortgage lending disputes, and other claims involving financial services. Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 7-8 (2004).[5] Arbitration agreements likewise appear in numerous other commercial contexts, as will no doubt be discussed by other *amici*.[6]

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[5] Available at http://www.ey.com/global/download.nsf/US/-Outcomes_of_Arbitration/$file/OutcomesofArbitrationAnEmpirical-Study.pdf.

[6] While the U.S. Chamber of Commerce is in a better position to discuss the use of arbitration clauses in the non-banking context, a few examples will suffice here to illustrate the widespread use of arbitration clauses throughout the economy. *See, e.g.*, *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 109 (2001) (employment agreement); *Wright* v. *Universal Maritime Service Corp.*, 525 U.S. 70, 72 (1998) (longshoremen's collective bargaining agreement); *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 54 (1995) (securities brokerage account agreement); *Allied-Bruce Terminix Companies, Inc.* v. *Dobson*, 513 U.S. 265, 268 (1995) (termite control contract); *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (registered securities representative registration/employment agreement); *Volt Information Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 470 (1989) (construction contract); *Mitsubishi Motors*, 473 U.S. at 616-17 (automobile manufacturer distribution and sales agreement); *General Atomic Co.* v. *Felter*, 436 U.S. 493, 494 (1978) (uranium supply agreement); *Prima Paint*, 388 U.S. 395 (paint manufacturing and sales consulting agreement).

Given the frequent and widespread use of arbitration clauses, it should come as no surprise that the specific issue raised by the petitioner likewise arises in numerous cases. Contracts containing arbitration clauses are frequently subject to claims that the underlying contract is illegal for some alleged substantive conflict with law or public policy that has nothing to do with the arbitration clause itself.

While many of the cases emphasized by petitioner involve the particular field of pay-day lending, claims of voidness arise frequently in other banking contexts as well. *See, e.g.*, *Branco* v. *Norwest Bank Minnesoa, N.A.*, -- F. Supp.2d --, 2005 WL 1866086, at *2 (D. Hawaii 2005) (challenging arbitration agreement by claiming, *inter alia*, that underlying loan agreement was void *ab initio* because it was formed in violation of consumer protection statutes); *Gipson* v. *Cross Country Bank*, 354 F. Supp.2d 1278, 1280 (M.D. Ala. 2005) (alleging credit card agreement to be void *ab initio* because it allowed bank to unilaterally change provisions); *Anderson* v. *Delta Funding Corp.*, 316 F. Supp.2d 554, 562 (N.D. Ohio 2004) (attempt to avoid arbitration clause by alleging that mortgage transaction was void *ab initio* based on supposed violations of Truth in Lending Act); *Taylor* v. *Citibank USA,*

N.A., 292 F. Supp.2d 1333, 1339 (M.D. Ala. 2003) (attempting to avoid arbitration by claiming credit card agreement was void *ab initio* because of alleged violation of Fair Credit Billing Act); *Stewart* v. *Favors*, 590 S.E.2d 186, 189 (Ga. App. 2003) (challenging arbitration provisions in a consumer loan transaction based, *inter alia*, on claim that loan transactions were void because part of illegal predatory lending scheme); *Earls* v. *Chase Bank of Texas, N.A.*, 59 P.3d 364, 365 (Mont. 2002) (challenge to a deed of trust as void *ab initio* based on alleged failure to follow certain statutory notice requirements in mortgage context).[7] The above are a mere sampling of banking cases showing that the issue of arbitrability of allegedly void contracts occurs in disputes far beyond the particular context of pay-day lending. Rather, the issue affects the entire banking industry in numerous contexts. The impact of the erroneous approach adopted by the Florida Supreme Court thus would be widespread and would substantially undermine the policy goals of the FAA.

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[7] In the non-banking context, there is an even greater variety of claims of substantive voidness, and the impact on arbitration clauses would be extensive. *See, e.g.*, *John B. Goodman Ltd. Partnership* v. *THF Constr., Inc.*, 321 F.3d 1094, 1096-97 (CA11 2003) (voidness of construction contract alleged based on performance by an unlicensed contractor); *Silver Dollar City, Inc.* v. *Kitsmiller Constr. Co.*, 874 S.W.2d 526, 536 (Mo. Ct. App. 1994) (alleged voidness or revocability of entire construction contract); *Mesa Operating Ltd. Partnership* v. *Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 244 (CA5 1986) (voidness alleged based on violation of state regulations for sale of certain gas); *Nature's 10 Jewelers* v. *Gunderson*, 648 N.W.2d 804, 805 (S.D. 2002) (voidness based on violation of franchise law); *Fazio*, 340 F.3d at 394-95 (voidness of brokerage account agreement based on alleged criminal embezzlement and fraud); *National R.R. Passenger Corp.*, 892 F.2d at 1070-71 (alleged voidness of indemnification agreement due to conflict with public policy regarding accountability for illegal acts causing injury); *R.P.T. of Aspen, Inc.* v. *Innovative Communications, Inc.*, 917 P.2d 340, 342 (Colo. Ct. App. 1996) (alleged voidness of telecommunications sales and marketing agreement based on violation of antitrust laws).

B. The FAA Sensibly Establishes a National Policy Favoring Expansive Enforcement of Arbitration Agreements.

The FAA sets forth a national policy favoring and protecting the use of voluntary arbitration agreements as an alternative form of dispute resolution. This Court has recognized "the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint*, 388 U.S. at 404; *see also Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 56 (1995) (FAA "not only 'declared a national policy favoring arbitration,' but actually 'withdrew the power of the states to require a judicial forum for resolution of claims which the contracting parties agreed to resolve by arbitration'") (citation omitted); *Shearson/American Exp., Inc.* v. *McMahon*, 482 U.S. 220, 226 (1987) (FAA "establishes a 'federal policy favoring arbitration,' * * * requiring that 'we rigorously enforce agreements to arbitrate * * * '") (citations omitted); *Peoples Sec. Life Ins. Co.* v. *Monumental Life Ins. Co.*, 867 F.2d 809, 813 (CA4 1989) ("the policies of the Act should be effectuated whenever possible, and federal courts should 'rigorously enforce agreements to arbitrate.'") (citation omitted).

That national policy is based on the well-founded congressional view that arbitration is a cost effective, speedy, and reliable alternative to litigation in the courts, which are often crowded, inefficient, time-consuming, and expensive.

In the banking industry in particular, Congress's policy judgment has proved to be entirely accurate, both from the business and consumer perspectives. Indeed, the Ernst & Young study found that arbitration in the consumer lending context had recognized advantages over litigation in connection with outcomes, process, costs, and timeliness. Ernst & Young, *Outcomes of Arbitration*, at 2. The study further found that consumers prevailed more often than businesses in cases that went to an arbitration hearing, consumers prevailed

close to 80% of the time when pre-hearing settlements were taken into account, and that nearly 70% of the consumers surveyed were either satisfied or very satisfied with the arbitration process. *Id.* at 7-8.

By shifting the resolution of claims of substantive illegality to the courts and away from arbitrators, the decision below renders arbitration clauses effectively meaningless in such cases. Even where a court ultimately rejects the claim of illegality, that issue will often have been the primary or sole issue in the case and a subsequent order to arbitrate will either be pointless or worse.[8] Claims of substantive illegality could readily be made to an arbitrator and there is no reason to think that arbitrators would be incapable of resolving such claims fairly and expeditiously.

Precluding the arbitration of claims of voidness is doubly problematic in that it not only undermines the use of arbitration, but is done out of an open distrust of the arbitration process itself. Such animus towards arbitration is in direct conflict with the policy of the FAA.

The court below, for example, claimed that it was unwilling to allow an arbitrator to decide the issue of illegality because "Florida public policy and contract law prohibit breathing life into a potentially illegal contract." Pet. App. 7a. But treating arbitration agreements as separate and severable contracts would not "breathe life" into the potentially offending remainder of the agreement – not unless you improperly presumed that arbitrators would systematically reach the *wrong* result and tend to uphold illegal contracts. In fact, the concurrence below is quite explicit in such improper disparagement of the arbitration process. Pet. App. 11a (Bell, J., specially concurring) ("The state's regulatory authority in the consumer protection area could be severely weakened if predatory lenders are allowed to circumvent the state courts and direct to arbitration claims that their lending practices violate state law."). The notion that state consumer protection will suffer from arbitration necessarily depends on the improperly hostile predicate that arbitrators are either biased or incompetent to decide such issues and will improperly rule against consumers.

[8] Should an unsuccessful litigant seek to reassert the alleged illegality before an arbitrator and deny that the prior resolution by the court is binding on the ultimate merits, the defending party will, at a minimum, be forced into the further expense of arbitrating the issues of *res judicata* or law-of-the-case and, if somehow unsuccessful on those issues, could be forced to re-litigate the substantive claim itself. Such a duplication of effort undermines the very purpose of arbitration clauses and the very value that Congress saw in arbitration when enacting the FAA.

Arbitration, however, is presumptively neutral toward state consumer protection and will produce results for or against the consumer depending on the specific merits of each case. (If anything, arbitration seems to be a *more favorable* forum for consumers than the courts themselves, particularly in the consumer lending context. *See supra*, at 15-16.) If the arbitrator agrees that the contract is illegal, he would rule accordingly and deny the illegal contract any effect. Allowing an arbitrator to reach that decision gives no effect to the illegal underlying contract, but rather properly treats it as severable from the arbitration agreement itself. It is only in the limited scenario where the arbitrator erroneously upholds an illegal contract that Florida public policy is even remotely at risk. But in such circumstances, there are other means of vindicating state policy. For example, the resulting arbitral decision could be challenged in court on the grounds that it requires the performance of some illegal act. *National R.R. Passenger Corp.*, 892 F.2d at 1071.

Florida's unwillingness to allow the arbitrator to make the decision in the first instance thus reflects a wholly unwarranted distrust of the arbitration process and the assumption that arbitrators will reach the wrong results and somehow skew disproportionately against Florida public policy. Not only is that assumption simply wrong as a factual matter (and unsupported by anything in the Florida Supreme Court's

opinion), it is also an impermissible basis for avoiding arbitration as a matter of federal law regardless of how state public policy might fare on average in arbitration. *Mitsubishi Motors*, 473 U.S. at 626-27 ("we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals" can prevent enforcement of the FAA as applied to claims alleging statutory violations); *Fletcher* v. *Kidder, Peabody & Co., Inc.*, 619 N.E.2d 998, 1006 (N.Y.) ("there is nothing in the present body of Federal law that supports carving out a special 'public policy' exception from the general rule of arbitrability mandated by the FAA"), *cert. denied*, 510 U.S. 993 (1993).

The strong federal policy in favor of expansive and rigorous enforcement of arbitration agreements militates against any attempt to undermine their effectiveness through indirect assaults on their validity. The separability doctrine not only represents the correct and sensible interpretation of the FAA and an efficient judicial approach to frequently arising questions, it also furthers the underlying policy goals of the FAA by protecting arbitration agreements from unrelated challenges to their validity and the seeming hostility of some courts.

CONCLUSION

For the foregoing reasons, the judgment of the Florida Supreme Court should be reversed.

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Dated: August 12, 2005.

No. 04-1264

Supreme Court, U.S.
FILED
SEP 23 2005
OFFICE OF THE CLERK

In The
Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ Of Certiorari To The Supreme Court Of Florida

BRIEF OF AMICUS CURIAE SAMUEL GLAZER IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE[1]

Amicus Curiae Samuel Glazer is the Petitioner in *Samuel Glazer v. Lehman Brothers, Inc., et al.*, No. 04-1375. Glazer's Petition for a Writ of Certiorari is currently pending and is scheduled for conference on September 26, 2005.

Glazer's lawsuit against Lehman Brothers, Inc., and SG Cowen Securities Corp. stems from probably the largest fraud ever committed by a single securities broker in this country, involving numerous investors and hundreds of millions of dollars. Samuel Glazer lost millions because these brokerage firms wilfully and unlawfully turned a blind eye to a shockingly open and obvious criminal in their employ. The breadth of the firms' malfeasance – in terms of length of time and the knowing continuance of violations of securities laws and regulations even in the face of explicit warnings – is described in Administrative Orders issued by the Securities and Exchange Commission and in non-prosecution agreements reached with Ohio county prosecutors.[2]

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[1] This brief is filed pursuant to each parties' general consent to the filing of all amicus briefs, filed by each party on August 1, 2005. This brief has not been authored, in whole or in part, by counsel for any party in this case. No person or entity other than Amicus Curiae, Samuel Glazer, or his counsel made a monetary contribution to the preparation or submission of this brief.

[2] *See* Lehman Bros., Inc., Exchange Act Release No. 48336, 80 SEC Docket 2512-39 (Aug. 14, 2003) ($2.5 million fine), *available at* http://www.sec.gov/litigation/admin/34-48335.htm; SG Cowen Secs. Corp., Exchange Act Release No. 48335, 80 SEC Docket 2501-38 (Aug. 14, 2003) ($5 million fine), *available at* http://www.sec.gov/litigation/admin/34-48336.htm.; *see* John Caniglia & Sandy Theis, *How County Got $9 Million*, Plain Dealer (Cleveland), Jan. 8, 2004, at A1.

In mid-1998, Glazer met Frank Gruttadauria, who was a broker, Managing Director, and Office Manager for SG Cowen Securities Corp. Glazer did not know it, but Gruttadauria was actually a full-time criminal. For over twelve years, Gruttadauria had been using the brokerage's systems and policies to steal money and stock from customer accounts, to divert real account statements to post office boxes to hide his fraud, and to create fake account statements for customers in order to hide his actions and to create the appearance of outstanding investment success.

Gruttadauria, who is now in prison, has admitted that he was desperate when he met Glazer. After stealing from customers for over 12 years, he needed "new money" to satisfy customers' recent withdrawal demands. Gruttadauria targeted Glazer, who is now in his eighties. Glazer told Gruttadauria he would not sign an account agreement containing an arbitration provision. Glazer had refused to sign such agreements in the past, including with SG Cowen's predecessor (Cowen & Co.). Gruttadauria told Glazer that his "title as managing Director of SG Cowen was sufficient to assure him that SG Cowen would not enforce arbitration against him." With this assurance, Glazer signed and transferred stock and cash which was immediately stolen by Gruttadauria. No legitimate transaction was ever made for Glazer, and he never received any legitimate account statement showing the reality of his assets being stolen. The brokerage firms do not dispute these facts.

Gruttadauria's criminal scheme finally collapsed in January of 2002, but not due to the brokerage firms. He disappeared and left a note for the FBI: "I can hardly believe that I could have done this without detection for so

long, the various firms greed and lack of attention at a senior level contributed greatly to that." It is now estimated that Gruttadauria stole between $115-$150 million in capital and created an additional $275-$300 million of fictional net worth in fake account statements printed from his office desktop computer.

Glazer sued Lehman and SG Cowen in federal court asserting several claims including statutory securities fraud, common law fraud, breach of fiduciary duty, and estoppel. The brokerage firms filed motions to compel arbitration based on the same account documents that were an integral part of Gruttadauria's crime. Glazer opposed the motions on the ground that the entire account agreement never came into existence, *i.e.*, was void from its inception, because Gruttadauria's criminal purpose barred the formation of any contract based on ordinary principles of state contract formation law. Glazer also asserted that Gruttadauria's lie about the arbitration provision barred enforcement of that provision. The District Court held that under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1 *et seq.*, it was authorized to determine whether the underlying account agreement came into existence. The District Court denied the motions to compel arbitration, ruling that because Gruttadauria never intended to act as a broker, but instead intended only to steal, there was never any meeting of the minds, never any underlying contract, and thus never any arbitration provision. *Fazio, et al. v. Lehman Bros., Inc., et al.*, 268 F. Supp. 2d 865 (N.D. Ohio 2002).

On appeal, the Sixth Circuit reversed and remanded. The Sixth Circuit completely refused to address Glazer's claim that no underlying contract ever came into existence. Relying on *Prima Paint v. Flood & Conklin Manufacturing*

Co., 388 U.S. 395 (1967), the court perfunctorily reversed and remanded with a mandate that the District Court only hear claims targeting the arbitration provision specifically, or claims of forgery or lack of signatory authority regarding the underlying agreement. *Fazio, et al. v. Lehman Bros. Inc., et al.*, 340 F.3d 386 (6th Cir. 2003).

On remand, *Prima Paint* "separability" was again an issue. Glazer re-asserted his challenge specifically concerning the arbitration provision, because Gruttadauria promised, and Glazer agreed, that arbitration would not be enforced. *Glazer v. Lehman Bros., Inc., et al.*, No. 1:02 CV 370 (N.D. Ohio Oct. 3, 2003). The District Court again refused to compel arbitration, but the Sixth Circuit again reversed. The court held that the oral agreement for no arbitration was barred by the parol evidence rule. But, in Ohio, an exception to parol evidence is the "sham agreement" doctrine, which provides that the parties can agree that the document they sign is not their real agreement (and therefore the contrary oral agreement is the real one and is enforced). The sham agreement doctrine only applies to whole contracts and not to discrete provisions. Glazer contended that the Sixth Circuit's view of separability required the court to view the arbitration provision as a whole, stand-alone contract, and thus apply the sham agreement doctrine to it. The Sixth Circuit disagreed, did not focus solely on the arbitration provision, and instead used the entire underlying contract as a basis for not applying the sham agreement doctrine.[3] *Glazer v. Lehman Bros., Inc., et al.*, 394 F.3d 444 (6th Cir. 2005)

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[3] Glazer's Petition for Writ of Certiorari seeks review of this second panel decision because it shows an improper, selective application of the "separability doctrine."

The first question presented by Glazer's Petition for a Writ of Certiorari is: "Must a court, and not an arbitrator, resolve *all* claims that the underlying contract is void from its inception?" This question directly encompasses the question accepted for review in the present case. Samuel Glazer's submission herein primarily supports the position of the Respondents.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article III of the United States Constitution:

> The judges, both of the supreme and inferior courts, shall hold their offices during good behaviour, and shall, at stated times, receive for their services, a compensation, which shall not be diminished during their continuance in office. . . . The judicial power shall extend to all cases, in law and equity, arising under this Constitution, the laws of the United States . . . [and] to controversies . . . between citizens of different states. . . . U.S. Const. art. III, §§ 1, 2.

The Fifth Amendment to the U.S. Constitution:

> No person shall be . . . deprived of life, liberty, or property, without due process of law. . . . U.S. Const. amend. V.

The Seventh Amendment to the U.S. Constitution:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any

> court of the United States, than according to the rules of the common law. U.S. Const. amend. VII.

The Fourteenth Amendment to the U.S. Constitution:

> [N]or shall any state deprive any person of life, liberty, or property, without due process of law. . . . U.S. Const. amend XIV, § 1.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (emphasis added):

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

Section 3 of the FAA, 9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Section 4 of the FAA, 9 U.S.C. § 4 (emphasis added):

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . *The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.*

SUMMARY OF ARGUMENT

The fundamental question for resolution in this case is whether, under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1 *et seq.*, a court or an arbitrator should resolve a claim that an underlying contract containing an arbitration provision never came into existence, or is void. The Petitioner, Buckeye Check Cashing, Inc. ("Buckeye"), contends that *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), should be extended to such claims. However, *Prima Paint*'s holding, commonly called the "separability doctrine," is founded upon a statutory default rule of assumed implied consent to arbitration. Amicus Curiae, Samuel Glazer, suggests that when a party opposing arbitration claims that no underlying contract ever came into existence based on state common law principles, or because the contract is void under a statute, *Prima Paint*'s rationale

of implied consent should not be controlling. A claim that no underlying contract came into existence directly implicates the arbitration clause because without the contract, no enforceable provision can arise from it, including an arbitration provision (no contract, no power). Application of *Prima Paint* also would result in an unacceptable circularity of logic – if an arbitrator rules no contract came into existence, then the arbitrator never had authority to issue his decision in the first instance. Arbitrators, who are paid for their time, are also placed in a position of conflicting interests when asked to resolve their own authority. Parties most likely do not anticipate such issues, and a court should not assume that they did so by assuming consent to arbitration.

For these reasons, the Court's decision in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), should control all claims that no underlying contract came into existence. The *First Options* Court recognized that parties do not expect such fundamental questions of arbitrability to be decided by the arbitrator, and that the FAA does not allow arbitral resolution of "arbitrability" issues absent clear and unmistakable evidence of the parties' actual consent to send such issues to an arbitrator. A broad, general arbitration provision is not sufficient to establish such actual consent. Buckeye and its supporting amici curiae portend a downfall of the national policy favoring quick arbitral resolution of claims if the Court does not extend *Prima Paint*. But, this Court cautioned in *First Options*: "[T]he basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." 514 U.S. at 947 (quotations and citations omitted).

ARGUMENT

The dispositive question of law in this case is: "Under the Federal Arbitration Act, who decides arbitrability when a party claims that the underlying contract containing the arbitration clause never came into existence?" The answer to this question necessitates resolving the palpable tension between this Court's 1967 decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), and the 1995 decision *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995). On the one hand, *Prima Paint*'s "separability doctrine" mandates that courts presume that parties implicitly agreed to arbitrate by virtue of the mere superficial appearance of an underlying contract. 388 U.S. at 402-04. On the other hand, under *First Options*, the Supreme Court held that courts, and not arbitrators, must decide arguments going to the basis of an arbitrator's authority unless the parties clearly and unmistakably granted the arbitrator authority to determine his or her own jurisdiction. 514 U.S. at 943-45.

It has been more than a generation since *Prima Paint*. Hostility to arbitration has long since waned, and no one can argue the ability of arbitrators to resolve complex issues of law and fact. Indeed, the arbitral forum and arbitrator are certainly capable of resolving the *merits* of the challenging contractual and statutory questions posed in Glazer's and Buckeye's cases. Capability is not the issue. The propriety of an arbitrator determining his or her own "power" under a doctrine of implied consent is the issue, and any such doctrine should be rejected. *First Options*' requirement of clear and unmistakable evidence of actual consent before an arbitrator can determine his or her own authority represents a more moderated approach

that adequately promotes and protects the voluntary nature of arbitration.

I. *PRIMA PAINT*'S "SEPARABILITY" RATIONALE IS BASED ON A STATUTORY DEFAULT RULE OF IMPLIED CONSENT THAT SHOULD NOT BE EXTENDED TO CLAIMS THAT AN UNDERLYING CONTRACT CONTAINING AN ARBITRATION PROVISION NEVER EXISTED.

A. The *Prima Paint* Decision

With the passage of the Federal Arbitration Act, Congress made arbitration agreements as enforceable as any other contract. The statute explicitly subjects arbitration agreements to the same defenses that can be asserted against any contract: such agreements are valid "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. This Court has unequivocally held that under the FAA, the question of whether the parties entered into an arbitration agreement must be determined under *state law* of contract formation. *See, e.g., First Options*, 514 U.S. at 944; *Allied-Bruce Terminex Cos. v. Dobson*, 513 U.S. 265, 281 (1995). The FAA specifically charges courts, and not arbitrators, with the task of determining this threshold question of whether an arbitration agreement was ever formed. Before requiring arbitration, a court must be "satisfied that the making of the agreement for arbitration . . . is not in issue." 9 U.S.C. § 4.

Thirty-eight years ago in *Prima Paint*, the Supreme Court first addressed the question under the FAA of whether an arbitrator or a court should decide a state law defense addressing the entire underlying contract. *Prima*

Paint involved a claim that a party had been fraudulently induced into entering a business acquisition agreement, which contained an arbitration provision. 388 U.S. at 396-400. The Court narrowly phrased "the central issue" in *Prima Paint* as: "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." 388 U.S. at 402. Based on Section 4 of the FAA, the *Prima Paint* Court held that a claim of fraudulent inducement "of the arbitration clause itself . . . goes to the 'making' of the agreement to arbitrate" and therefore must be decided by a court. *Id.* at 403-04. In contrast, a claim of fraudulent inducement targeting the underlying container contract does not implicate the making of the arbitration agreement and should therefore be resolved by an arbitrator. *Id.*

This division of authority -- which commonly came to be known as the "separability doctrine" – effectively created a statutory default rule of implied consent. Unless parties agree otherwise, *Prima Paint* interpreted the statutory scheme of the FAA to require a court to assume that parties intend fraudulent inducement claims targeting the underlying contract to be resolved by the arbitrator. The *Prima Paint* Court expressed no opinion as to who decides arbitrability relative to any claim other than that of fraudulent inducement.

B. Courts' Broad Extension of *Prima Paint*

The Court in *Prima Paint* addressed only claims of fraudulent inducement, and courts have since grappled with how far to extend the decision. Many courts have extended *Prima Paint*'s holding in order to compel arbitration of

virtually all claims that the underlying contract never came into existence. These courts automatically refuse to consider such claims, and they do so based on *Prima Paint*'s default rule of implied consent. The only exceptions to the implied consent rule recognized by these courts are the narrowest types of "assent" claims, such as claims that the signature on the underlying contract was forged or that the signing party lacked signatory authority.

Glazer's case is a great example. In Glazer's case below, *Fazio, et al. v. Lehman Brothers, Inc., et al.*, 340 F.3d 386 (2003), Glazer claimed that the underlying contract never came into existence under ordinary principles of state law. The District Court addressed this claim and ruled in favor of Glazer. The Sixth Circuit refused to consider any law or fact regarding this claim. The court applied *Prima Paint*, *Burden v. Check Into Cash*, 267 F.3d 483 (6th Cir. 2001), *cert. denied*, 535 U.S. 970 (2002), and *CBS Employees Federal Credit Union v. Donaldson, Lufkin & Jenrette Secs. Corp.*, 912 F.3d 1564, 1566 (6th Cir. 1990), in what amounted to a perfunctory application of the "separability doctrine." The court summarized the rule that "when claims involve the validity of the contract as a whole and not just the arbitration agreement, such claims are to be brought before the arbitrator. . . ." 340 F.3d at 395 (quotations omitted). The court remanded only issues of forgery and signatory power issues addressing the underlying contract. *Id.* at 397 (citing *Burden*, 267 F.3d at 488-90 (holding that the district court erred in determining allegations of voidness under usury and

lender licensing laws because they did not involve assent)).[4]

Buckeye would have this Court endorse this broad application of *Prima Paint* by sending all claims that the underlying contract is void under state law to arbitration, subject only to "two qualifications." (Pet. Brief at 16.) First, Buckeye concedes that "a challenge directed at the underlying contract goes to the court if it implicates the parties' assent [*in factum*], because a party that did not assent to the underlying contract by definition did not assent to an embedded arbitration clause." (*Id.*) Glazer agrees with this result. Second, Buckeye acknowledges that the parties can "clearly and unmistakably" agree that "a challenge directed at the arbitration clause" itself can be submitted to arbitration. (*Id.*) Buckeye's second qualification references this Court's holding in *First Options of Chicago, Inc. v. Kaplan*, but it fails to acknowledge that the fundamental holding of that case was much broader. *First Options* generally established a requirement that parties must clearly and unmistakably consent to having an arbitrator resolve a claim regarding the basis of the arbitrator's authority. 514 U.S. at 944-45. *First Options* provides the precise framework for resolving claims that the underlying contract never came into existence, as explained in Section II of this brief.

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[4] *See also Jenkins v. First Am. Cash Advance*, 400 F.3d 868, 882 n.12 (11th Cir. 2005) (following *Burden* under similar facts); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 637 (4th Cir.), *cert. denied*, 537 U.S. 1087 (2002) (following *Burden* under similar facts); *Will Drill Res., Inc. v. Samson Res. Co.*, 352 F.3d 211, 215 n.15 (5th Cir. 2001) (rejecting the void-voidable distinction but reserving for the court allegations that the underlying contract was not signed by all necessary parties).

Buckeye and these courts cannot deny the conceptual horror of a court enforcing an arbitration provision in a contract only to have an arbitrator determine that the party's signature to the underlying contract truly was forged. However, by creating exceptions only for claims regarding assent, they ignore a simple reality: *All* claims that an underlying contract *never existed* under state law – for any reason – necessarily place at issue the making of every provision in the contract, including the arbitration provision. Put succinctly, "No contract, no power." *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001).

For this reason, *Prima Paint* should only apply (if at all) where a party impliedly acknowledges by the nature of its claim that the underlying contract came into existence by seeking to rescind it.[5] The elementary distinction between void and voidable contracts under state law has been recognized by many courts that properly limit *Prima Paint* to claims that an underlying contract is voidable. The leading case is *Sandvik AB v. Advent International Corp.*, 220 F.3d 99, 107-09 (3d Cir. 2000), in which the Third Circuit aptly explained the reasoning behind treating void and voidable claims distinctly:

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[5] A void or void *ab initio* contract "produces no legal obligation." Because it "does not come into existence . . . it cannot be a contract" at all. In contrast, a voidable contract "is an agreement that unless rescinded . . . imposes on parties the same obligations as if it were not voidable." *Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 32 (2d Cir. 2001) (quotations omitted); *see also, e.g., Langley v. FDIC*, 484 U.S. 86, 93-94 (1987) (explaining the different legal effects of void and voidable contracts, citing the Uniform Commercial Code, the Restatement (Second) of Contracts, and Farnsworth's treatise).

> Allowing the District Court to pass on the question whether the arbitration agreement is valid . . . comports with contract law principles. . . . [A]rbitration is a matter of contract, and no arbitration may be compelled in the absence of an agreement to arbitrate. . . . Therefore, there does not appear to be any independent source of validity of the arbitration clause once the underlying contract is taken off the table.

Id. at 107-08; *see also, e.g., Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 30-32 (2d Cir. 2001) (explaining the void-voidable distinction). A party alleging that the underlying contract is voidable, does not, by definition, allege that the underlying contract never came into existence. Because *Prima Paint* did not present a situation in which the arbitrator was asked to determine the very basis for his or her own authority, the claims of fraudulent inducement were properly sent to arbitration.

If no underlying contract was ever formed, no enforceable provision can arise out of it, including an arbitration provision. Buckeye and the courts that apply *Prima Paint* broadly and improperly elevate arbitration provisions to a special legal status, impervious to state law, when they extend *Prima Paint*'s default rule of implied consent even to questions regarding the existence of the underlying contract. This Court's decision in *First Options of Chicago, Inc. v. Kaplan*, which requires clear and unmistakable evidence of actual consent to arbitrate arbitrability, establishes the proper framework for resolving claims that implicate the very basis of the arbitrator's authority.

II. *FIRST OPTIONS* REQUIRES THAT COURTS RESOLVE A CLAIM THAT NO UNDERLYING CONTRACT EXISTS, UNLESS THE PARTIES CLEARLY AND UNMISTAKABLY EVIDENCE THEIR ACTUAL CONSENT TO SEND SUCH A CLAIM TO ARBITRATION.

Conspicuously absent from the briefs of Buckeye, and amici curiae in support of Buckeye, is a proper recognition of *First Options*. In *First Options of Chicago, Inc. v. Kaplan*, this Court addressed whether an arbitrator could determine the basis for his or her own authority when a party claimed that it never entered into the underlying contract. This Court refused to recognize implied consent to arbitrate this arbitrability question, holding that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they agreed to do so." 514 U.S. at 944 (quotations omitted).

In *First Options*, a stock trading firm (First Options) sought to arbitrate its claims for payment under a debt work-out agreement against Manuel Kaplan, Carol Kaplan, and Manuel Kaplans' investment company. 514 U.S. at 940. Although the investment company signed a document containing an arbitration agreement, the Kaplans themselves did not sign the document, and they contended that First Options' claims against them were therefore not arbitrable. *Id.* at 941. The arbitrators decided that they had jurisdiction to rule on the merits of all the disputes, and they rendered a decision in favor of First Options. *Id.*

The Kaplans asked this Court to review the question of whether the court or the arbitrator should have the primary power to decide "whether they agreed to arbitrate the merits." *Id.* at 942. The Court divided this question

into three levels of sub-questions: (1) the "merits" question – whether the Kaplans were liable to First Options under the work-out contract; (2) the "arbitrability" question – whether the Kaplans decided to arbitrate the merits; and (3) "who should have the primary power to decide" the second-level question. *Id.*

In analyzing the Kaplans' third-level question, the Court explicitly reversed any pro-arbitration presumption when arbitrators are asked to determine the existence of their own authority:

> Courts should not assume that the parties agreed to arbitrate arbitrability unless there is "clear and unmistakable" evidence that they did so. In this manner the law treats silence or ambiguity about the question "*who* (primarily) should decide arbitrability" differently from the way it treats silence or ambiguity about the question "*whether* a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement" – for in respect to this latter question the law reverses the presumption.

Id. at 944-45 (citations omitted). Therefore, under *First Options*, clear and unmistakable evidence of actual consent is necessary before a claim concerning arbitrability can be sent to arbitration.

Sending to arbitration a claim that the underlying contract never came into existence also improperly empowers an arbitrator to decide the basis of his or her own power. A uniquely circular issue arises – if the contract never existed, then the arbitrator never had any authority in the first place. In addition to this logic conundrum, it cannot seriously be denied that an arbitrator has a clear

financial interest in finding and retaining jurisdiction. Even if he does not act on that interest, the appearance of a potential conflict of interest remains.[6] The circularity of logic and potential conflict of interest merit strongly against *Prima Paint*'s default implied consent model, and heavily in favor of the *First Options*' requirement of actual consent to arbitrator resolution of "third-level" arbitrability questions via clear and unmistakable evidence. This requirement best maintains court and arbitral integrity, and avoids potential constitutional concerns. *Cf. Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145 (1968) (holding that an arbitrator's regular service as an engineering consultant for a party was grounds to vacate the arbitrator's decision, even without reason to suspect that the arbitrator acted out of bias); *see also Prima Paint*, 388 U.S. at 416 (Black, J., dissenting) ("I think it raises serious issues of due process to submit to an arbitrator an issue which will determine his compensation."); *Connally v. Georgia*, 429 U.S. 245 (1977) (holding that the issuance of a search warrant by a justice of the peace who was compensated based on the number of search warrants issued violated due process); *Gibson v. Berryhill*, 411 U.S. 564 (1973) (finding bias where a state agency regulating optometry was composed of independent optometrists who had an interest in revoking the licenses of optometrists employed by large businesses).

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[6] Tellingly, over the Kaplans' objections, the arbitrators in *First Options* chose to retain jurisdiction when faced with the question of whether the parties had agreed to arbitrate in the first place. 514 U.S. at 941. This is *not* to suggest that all arbitrators will necessarily act out of self-interest, but even the appearance of such potential impropriety counsels in favor of requiring clear and unmistakable consent to arbitrate.

As a policy matter, this Court has recognized that when a party claims it never agreed to arbitrate in the first place, consent to arbitration of this claim cannot be assumed from that party's "silence or ambiguity" because "doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide." *First Options*, 514 U.S. at 945. Express consent is necessary because "[a] party often might not focus upon that question or upon the significance of having arbitrators decide the scope of their own powers." *Id.* at 945.

Buckeye, and amici curiae supporting Buckeye, contend that any rejection of their position on *Prima Paint* "separability" will cause undue delays and will thus undermine a national policy favoring arbitration as a quick resolution of disputes. Not only are such concerns without basis, but this Court cautioned in *First Options* that "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." *Id.* at 947 (quotations and citations omitted). The FAA and this Courts' rulings should not be used as mere conveniences to clear court dockets.

A requirement of express consent also comports with the clear legislative history of the FAA and parties' constitutional rights. By applying *Prima Paint*'s default rule of implied consent even when it is alleged that the underlying contract never existed, Buckeye, and the courts that broadly apply *Prima Paint*, improperly elevate arbitration provisions above state law. This result contravenes the very purpose of the FAA as declared by Congress, which was "simply to make the contracting party live up to his

agreement" by placing an arbitration agreement "upon the same footing as other contracts, where it belongs." H.R. Rep. No. 96, at 1 (1924); *see also* Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 279 (1926) ("No one is required to make an agreement to arbitrate. Such action by a party is entirely voluntary. When the agreement to arbitrate *is* made, it is not left outside of the law.... It is merely a new method for enforcing a contract freely made by the parties thereto.").

The American Bar Association's proponent of the FAA explained:

> A Federal statute providing for the enforcement of arbitration agreements does relate solely to the procedure of the Federal courts. It is no infringement upon the right of each State to decide for itself what contracts shall or shall not exist under its laws. To be sure whether or not a contract exists is a question of the substantive law of the jurisdiction wherein the contract was made.

Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong. 37 (1924) [hereinafter *Joint Hearings*] (brief submitted by Julius Henry Cohen).

Indeed, this Court has consistently reaffirmed adherence to the state law of contract formation:

> In any event, § 2 gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law

> or in equity for the revocation of any contract." 9 U.S.C. § 2 (emphasis added). What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal "footing," directly contrary to the Act's language and Congress' intent.

Allied-Bruce Terminex Cos. v. Dobson, 513 U.S. 265, 281 (1995). Buckeye and many courts would ignore states' rights to determine which contracts exist and which do not.

Not only is the result urged by Buckeye untenable under the FAA, but it contravenes the Constitution. Congress recognized the need to preserve these rights:

> *The one constitutional provision we have got is that you have a right of trial by jury.* But you can waive that. And you can do that in advance. Ah, but the question whether you waive it or not depends on whether that is your signature to the paper, or whether you authorized that signature, *or whether the paper is a valid paper or not*, whether it was delivered properly. So there is a question there that you have *not waived* the right of trial by jury on.

Joint Hearings at 15-17 (statement of Julius Henry Cohen addressing concerns about "take-it-or-leave-it" contracts) (emphasis added).

Depriving a party of its right to have a court determine the making of the arbitration agreement violates that party's rights to a judicial forum under Article III, a

jury trial under the Seventh Amendment, and due process under the Fifth and Fourteenth Amendments. *See, e.g.*, *Prima Paint*, 388 U.S. at 407 (Black, J., dissenting, Stewart, J., Douglas, J., joining) (stating that "forcing a person to forgo his opportunity to try his legal issues in the courts where, unlike the situation in arbitration, he may have a jury trial and right to appeal" may be a "denial of due process"); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) (holding that Congressional action requiring that bankruptcy-related claims be resolved in a non-Article III forum without the use of a jury may violate parties' Article III and Seventh Amendment rights). Requiring clear and unmistakable, actual consent before an arbitrator is permitted to decide the existence of the underlying contract containing the arbitration provision best preserves the parties' rights.

CONCLUSION

To quote Judge Frank Easterbrook, *Prima Paint* "sits uneasily aside" *First Options. Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 590 (7th Cir. 2001). For the reasons stated in this brief, overturning *Prima Paint* should be considered by this Court, if not in the current case then in another appropriate case. At a minimum, the holding of *Prima Paint* should not be extended to claims that the underlying contract containing the arbitration provision never came into existence. Such claims directly implicate the arbitrator's authority and result in an unacceptable circularity of logic that, frankly, most ordinary people signing contracts throughout our economy and across industries will find both surprising and wholly unacceptable. Indeed, the integrity of the courts and arbitration is at

stake. Buckeye and amici curiae in support of Buckeye trumpet a parade of "horribles" if *Prima Paint*'s "separability doctrine" is not extended to require arbitration of claims that no underlying contract exists. They too easily ignore this Court's cautionary warning: "[T]he basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms." *First Options*, 514 U.S. at 947 (quotations and citations omitted). *Prima Paint* should at least be limited to its discrete facts involving a claim that the underlying contract was voidable, and not that it was void or never existed in the first place. *First Options* and its "clear and unmistakable" standard of actual consent to arbitration should be applied to all claims that the underlying contract never came into existence. This framework best protects parties' rights under the FAA, Congress' intent, the voluntary contractual nature of arbitration, parties' expectations, and the parties' Constitutional rights.

Respectfully submitted,

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FILED
SEP 23 2005
OFFICE OF THE CLERK
SUPREME COURT, U.S.

(14)

No. 04-1264

In the
Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioners,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ of Certiorari to the Supreme Court of Florida

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INTEREST OF *AMICI CURIAE*

Amici are law professors whose teaching and scholarship involve the fields of contracts, commercial law, and related areas of law. The Federal Arbitration Act incorporates the law of contracts into its Section 2, which–absent a maritime transaction–requires a "contract" for the FAA to apply. *Amici* seek to provide perspective on the common law doctrine that a centrally illegal bargain is *void ab initio* as a contract. Florida follows this venerable approach.

SUMMARY OF ARGUMENT

The question presented in this case is whether Section 2 of the Federal Arbitration Act (FAA), 9 U.S.C. § 2, preempts state law so as to bar a state court from deciding whether loan transactions alleged to be criminal are *void ab initio* as contracts, so that no part of them–including any arbitration clause–is given legal effect. The Florida Supreme Court concluded that the FAA does not preclude a state court asked to compel arbitration from first deciding whether the payday lending transactions in question violated Florida felony and misdemeanor statutes against loansharking.[1] According to the Florida Supreme Court, if the loans are found illegal, then under Florida common law, they would not be given legal effect as contracts and thus none of their provisions would be valid and enforceable. *Cardegna v. Buckeye Check Cashing,*

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[1] It should be noted that after the transactions in issue in this case, Florida enacted a statute permitting high rates of interest in payday loans, while also providing for regulation of providers and of certain terms. Fla. Stat. §§ 560.402-560.408 (Added by Laws 2001, c. 2001-119, § 13, eff. Oct. 1, 2001; Amended by Laws 2003, c. 2003-261, § 725, eff. June 26, 2003). The allegation of the borrowers here is that prior to enactment of this law, Buckeye violated applicable criminal loansharking statutes. See Fla. Stat. §§ 687.071(1)(f), 687.071(2)-(3).

Inc., 894 So. 2d 860, 863 (Fla. 2005). Furthermore, the Florida Supreme Court held that where one party makes a colorable allegation that there was no contract due to illegality, a state court should not compel arbitration until it decides the illegality issue. *Id.* at 865.

This case involves a basic principle of federalism. Contract law is state law, and this Court disfavors preemption in areas traditionally governed by state law. *See Bates v. Dow Agrosciences*, LLC., 125 S. Ct. 1788, 1801 (2005). The only possible type of preemption here is implied conflict preemption. *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S.468, 477-78 (1989). This Court has held that Section 2 of the FAA preempts state law that targets arbitration clauses for disfavored treatment, not that it preempts generally applicable state contract law as applied to bargains with arbitration clauses. *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). Far from being in conflict with general contract law, FAA Section 2 explicitly incorporates contract law into its scheme, using the word "contract" four times.

The FAA requires any court called upon to compel arbitration under the FAA to determine whether the FAA is applicable. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401 (1967) (deciding, as the threshold question in the case, whether the agreement in question was a contract in commerce covered by FAA Section 2). Because there is no federal district court jurisdiction in this case and a state court is being asked to compel arbitration, the only FAA provision in issue is Section 2. The relevant language of that section sets a threshold requirement of a "contract" in order for the FAA to

be applicable to validate an arbitration clause. If no contract is recognized under Florida law due to criminal illegality, the FAA does not operate to validate the arbitration clause. Issues about FAA applicability under Section 2, including whether there is a "contract," must be decided by any court, state or federal, that is asked to stay litigation or compel arbitration.

The legal term "contract" has long been reserved for a promise or set of promises that the law enforces or in some way treats as creating a duty. RESTATEMENT (SECOND) OF CONTRACTS, Section 1 (1981) and RESTATEMENT OF CONTRACTS, Section 1 (1932). Respecting state public policy enacted in its criminal statutes, Florida common law denies the existence of a contract in a criminal loansharking transaction. The transaction is *void ab initio* as a contract, meaning the bargain is not a contract at all. To protect the integrity of its courts, Florida common law refuses judicial aid in the enforcement of any provision in a centrally criminal transaction. This approach is in keeping with longstanding Anglo-American contract law doctrine going back at least 150 years before enactment of the FAA, when Lord Mansfield wrote, "No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act." *Holman v. Johnson*, 1 Cowp. 341, 343, 98 Eng. Rep. 1120, 1121 (King's Bench 1775). To avoid giving aid to a criminal, a Florida court must as a first step decide whether the transaction is illegal.

In summary, the scope of this case is narrow in many ways. It comes from state, not federal court, and raises an issue only under FAA Section 2: whether Section 2 preempts the contract law of states, such as Florida, that treat centrally illegal bargains as *void ab initio* and therefore not contracts.

ARGUMENT

I. A COURT ASKED TO COMPEL ARBITRATION UNDER THE FAA MUST FIRST DECIDE WHETHER THE FAA APPLIES, INCLUDING ANY COLORABLE ISSUE ABOUT THE EXISTENCE OF A CONTRACT UNDER STATE LAW.

A. NOTHING IN SECTION 2 OF THE FAA PREEMPTS GENERALLY APPLICABLE STATE LAW CONCERNING WHETHER A CONTRACT EXISTS.

This Court must interpret Section 2 of the FAA to decide this case. Section 4 explicitly applies only when a federal district court is asked to compel arbitration in a case in which it otherwise has jurisdiction.[2] In this case, when Buckeye attempted to invoke Section 4 to compel arbitration, the federal district court remanded the case to state court, holding that Buckeye had failed to establish that the amount in controversy exceeded the threshold for diversity jurisdiction. Pet. Brief at 7.

There is no indication in the language of Section 2 that it preempts Florida common law concerning illegal bargains *void ab initio* as contracts. To the contrary, under the only applicable language of FAA Section 2, there must be a

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[2] *See Southland Corp. v. Keating*, 465 U.S. 1, 16, n. 10 (1984), stating: "In holding that the Arbitration Act preempts state law that withdraws the power to enforce arbitration agreements, we do not hold that §§3 and 4 of the Arbitration Act apply to proceedings in state courts. Section 4, for example, provides that the Federal Rules of Civil Procedure apply in proceedings to compel arbitration. The Federal Rules do not apply in such state court proceedings."

"contract" for the federal statute to apply and validate an arbitration clause in that contract. Furthermore, a reading of the FAA as a whole shows that the question whether a contract was formed or exists at all, so as to make the FAA applicable, is a threshold question for the court, whether the case is in state or federal court. The sections of the FAA are "integral parts of a whole." *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198, 201 (1956) (discussing FAA §§ 1-3). Sections 3 and 4 of the FAA assume a transaction within the scope of the federal statute under Sections 1 and 2. *Id.* and *Prima Paint*, 388 U.S. at 401. Section 2 applies when either a state or a federal court is presented with an issue concerning whether a dispute is arbitrable under the FAA. Under Florida common law and the common law of some other states, certain illegal transactions are not given effect as contracts. In such cases, the FAA's threshold requirement of "a contract" is not met, and thus the FAA does not apply to validate an arbitration clause in the deal.

B. THE FAA DOES NOT APPLY TO VALIDATE AN ARBITRATION CLAUSE IN THIS CASE UNLESS THERE IS "A CONTRACT," A THRESHOLD QUESTION FOR A COURT.

Section 2 of the FAA validates and makes enforceable written arbitration clauses in certain transactions and contracts. The only category applicable here is when there is "a written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a dispute thereafter arising out of such contract ...."[3] The operative language uses the word "contract" twice. First, there must be a written provision for

[3] The other categories are "a written provision in a maritime transaction...to settle by arbitration a dispute thereafter arising out of such ...transaction..." or "an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction or refusal...."

arbitration in "a contract." Furthermore, the dispute to be settled by arbitration must "arise out of such contract."[4] The word "contract" is not used casually to refer to a writing, because the requirement of a written provision is separately spelled out. Also, the second reference to "a dispute thereafter arising out of such contract" makes clear that "contract" is used to refer to more than the writing. Finally, the use of the word "contract" in the savings clause at the end of Section 2, referring to legal and equitable grounds for revocation of any contract, also makes clear the word "contract" is used in Section 2 in the technical legal sense of an enforceable promise or set of promises, as discussed further below in Section II.A. (distinguishing a "contract" from an "agreement.")

Although not in issue in this case, Section 1 provides definitions applicable in Section 2.[5] Courts must decide issues under Section 1 and 2 that go to the applicability of the FAA. For example, this Court has interpreted the phrase in Section 2 "involving commerce" as the equivalent of "affecting commerce" and as extending the FAA's reach to the extent of Congress's power under the Commerce Clause. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 273-277 (1995).

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[4] Also, although not in issue in this case, Section 2 requires that the contract's arbitration provision must be "written," which under the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. §§ 7001-7031, includes an electronic record, and the contract must be one "involving commerce."

[5] Section 1 defines "maritime transactions" broadly to cover contractual and non-contractual transactions, including, for example, "collisions," which is presumably why the phrase "maritime transactions" is used rather than "maritime contracts." Section 1 also defines "commerce" to cover, *inter alia*, "commerce among the several states."

In cases in state or federal court, Section 2's requirements must be met for the FAA to apply: there must be a written arbitration clause and, absent a maritime transaction, a contract involving commerce. In addition, in cases in state or federal court, the last clause of Section 2 is a savings provision for certain general legal and equitable contract law doctrines. Section 2 validates a written arbitration clause in a maritime transaction or contract involving commerce, but with this limitation: "save upon such grounds as exist at law or in equity for the revocation of any contract." Section 2 uses the word "contract" a total of four times, while Sections 3 and 4 do not use the word at all, but rather refer to an "agreement" for arbitration. Given the cumulative nature of the FAA, Sections 3 and 4 assume a contract, absent a maritime transaction.[6] *Prima Paint*, 388 U.S. at 401.

As discussed in Section II below, Florida law does not recognize the existence of a contract in cases of bargains *void ab initio*. Thus, the FAA, which requires a "contract" in this case, does not apply to validate an arbitration clause. Where state law makes a bargain *void ab initio* as a contract due to criminal illegality, there is no contract to make the FAA applicable.

Contract law questions, including whether a contract exists and whether there is a contract defense to enforcement of an arbitration clause under the savings clause of Section 2, are

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[6] In cases involving federal district court jurisdiction under Sections 3 (concerning staying federal litigation) or 4 (concerning ordering arbitration), Sections 1 and 2 also apply. Sections 3 and 4 are not in issue in this case because there is no basis for federal district court jurisdiction, but the cumulative nature of Sections 1-4 is a key feature of the structure of the FAA.

matters of state law. This Court has so recognized, in discussions of the savings clause for general doctrines giving grounds for revocation of any contract. *Perry v. Thomas*, 482 U.S. 483, 492, n. 9 (1987), and *Doctor's Associates*, 517 U.S. at 686-687. Given the Court's sound conclusion that the last reference to "contract" in Section 2 of the FAA refers to state law, it follows that all the references to "contract" in Section 2 (a total of four) refer to state law. Furthermore, a court must decide issues concerning the applicability of the FAA, including whether a contract exists or whether there is a generally applicable contract defense to an arbitration clause.

Buckeye argues that *Prima Paint* is controlling authority for the proposition that an arbitrator must decide the illegality issue in this case. We agree that *Prima Paint* is relevant authority, but not in the way that Buckeye suggests. *Prima Paint* interpreted Section 3 of the FAA as applied to a case involving fraud in the inducement to a deal that was conceded to be a contract. In contrast, the issue in this case is whether there is a contract, which is required by Section 2 for the FAA to apply to validate the arbitration clause. Furthermore, Sections 3 and 4 do not apply in this case because they address the role of federal courts, and this case instead involves the role of a state court.

The Court in *Prima Paint* stated that the stay provisions of Section 3 only apply to the "kinds of contracts specified in §§ 1 and 2 of the Act...." *Prima Paint*, 388 U.S. at 401. The Court found it necessary to answer as "[o]ur first question" an issue under Section 2, specifically whether the contract in question was one in commerce and thus "within the coverage of the Arbitration Act." *Id.* at 401-402. Thus, *Prima Paint* is

not authority for the principle that the requirements of FAA Section 2 fall away when a stay of arbitration or an order to arbitrate is sought, even when Section 3 or 4 applies. Quite the contrary, *Prima Paint* is authority for a key point that is in issue in this case: that Section 2 requirements for FAA applicability are threshold questions for any court asked to compel arbitration or stay litigation under the FAA. As the U.S. Court of Appeals for the 7th Circuit has explained, "as arbitration depends on a valid contract an argument that the contract does not exist can't logically be resolved by the arbitrator." *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F. 2d 587, 591 (2001) (holding that court must decide whether person who signed an arbitration agreement had authority to do so). *See also Sandvik v. Advent Int'l Corp.*, 220 F. 3d 99, 100-101, 109-110, & n. 7 (2000) (holding that court must decide whether the agent who signed a putative contract had authority and noting valid distinction between void and voidable contracts, the former not being contracts at all); *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co., Inc.*, 925 F. 2d 1136, 1140 , 1144 (1991) (same).

In *Prima Paint*, no issue was raised as to whether there was a contract. The very first sentence of Justice Fortas's opinion for the Court referred to the case as involving "a *contract* governed by the United States Arbitration Act of 1925" and also referred to the litigants as "the *contracting* parties." *Id.* at 397. [Emphasis added.] The Court determined that the contract was in interstate commerce and then stated, "Having determined that the *contract* in question is within the coverage of the Arbitration Act, we turn to the central issue in this case: whether a claim of fraud in the inducement of the entire *contract* is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." [Emphasis added.]

The plaintiff, Prima Paint, sought rescission of the contract on the basis of fraud in the inducement, but never questioned that a contract had been formed. Rather, the question presented was under Section 3, dealing with staying federal court litigation. The Court held that the language of Section 4, concerning whether there is an issue about "the making of the arbitration agreement," implicitly applies in Section 3 as well. *Id.* at 404. It certainly did not hold that an arbitration clause is enforceable even though no contract exists under state law.

II. UNDER FLORIDA LAW, CONSISTENT WITH LONGSTANDING PRINCIPLES OF CONTRACT LAW, A BARGAIN THAT IS VOID AB INITIO DUE TO ILLEGALITY IS NOT A CONTRACT.

A. A CONTRACT IS DIFFERENT FROM AN AGREEMENT.

It has long been understood that an "an agreement" is different from "a contract." An "agreement" is "an expression by two or more persons of assent," while a "contract" is "a promise, or set of promises, to which the law attaches legal obligation." These are the definitions in Sections 1 and 2 of Samuel Williston's 1920 treatise, WILLISTON ON CONTRACTS, VOL. I, 1-2. Thus, the distinction between an agreement and a contract was well understood when Congress enacted the FAA in 1925. Furthermore, given this understanding as well as the careful way the word "contract" is repeated four times in FAA Section 2, it is reasonable to conclude that the words "agreement" and "contract" in the FAA were not synonyms and were used to mean different things.

Drafting of the RESTATEMENT OF CONTRACTS (1932) began in 1923. See RESTATEMENT, Introduction, at ix. Therefore, the first RESTATEMENT is also evidence contemporaneous with the FAA of the meaning of the terms "agreement" and "contract." Given that Williston was the RESTATEMENT's Reporter, it is not surprising that the substance of his treatise definitions was used in the first RESTATEMENT definitions of contract and agreement in Sections 1 and 3. Section 1 defines a contract as "a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." Section 3 defines an agreement as "a manifestation of mutual assent by two or more persons to one another."

Williston's definitions also were carried forward in the RESTATEMENT (SECOND) OF CONTRACTS (1981), Sections 1 and 3. Comment a to Section 3 of the RESTATEMENT (SECOND) notes the way in which the meaning of agreement is broader than that of contract: "The word 'agreement' contains no implication that legal consequences are or are not produced." Another comment states that if the law "neither gives a remedy nor otherwise recognizes a duty of performance," then there is "not a contract at all." RESTATEMENT (SECOND), Section 7, cmt. a.

The Uniform Commercial Code (UCC) also distinguishes between "an agreement" and "a contract." An "agreement" is "the bargain of the parties in fact, as found in their language or inferred from other circumstances...." UCC, Section 1-201(b)(3) (2005 Official Text). A contract is the "total legal obligation that results from the parties' agreement...." *Id.* at Section 1-201(b)(12). Thus, like the Restatements, the UCC

emphasizes that the term "contract" entails legal obligation, not just factual agreement.

B. UNDER FLORIDA LAW, A CRIMINAL LOANSHARKING BARGAIN IS *VOID AB INITIO* AND THUS IS NOT A CONTRACT.

Section 2 reserves for the courts issues of contract law concerning whether a contract exists. These include formation issues under either of the two generally recognized forms of contract, contracts involving mutual manifestation of assent supported by consideration or those based on reliance on a promise (also known as promissory estoppel). *See* RESTATEMENT (SECOND) OF CONTRACTS, Section 1 (defining "contract"), Sections 17-81 (recognizing contracts with consideration) and Sections 82-94 (recognizing contracts without consideration). Absent a maritime transaction, the existence of a contract is a threshold question for FAA applicability. Thus, a case such as *Chastain v. Robinson-Humphrey Co.*, 957 F. 2d 851 (11th Cir. 1992), involving an issue of contract formation, is easy; a question about whether a party manifested assent to a deal is a question of contract formation to be decided under the first two references to "contract" in Section 2, not under Section 4. In *Chastain*, 957 F. 2d at 853-854, the court cited Sections 2, 3 and 4 of the FAA and held that a court must decide a challenge to the existence of any agreement at all, because in such circumstances, "there is no presumptively valid general *contract* which would trigger the district court's duty to compel arbitration pursuant to the Act." [Emphasis added.]

Another doctrine that goes to the existence of a contract is illegality that makes a bargain *void ab initio* as a contract. Florida state courts have refused to give legal recognition to illegal bargains on a number of occasions, both recently and going back to before the enactment of the FAA and before it was being applied in state courts, indicating the doctrine is a general one and not an attempt to avoid sending cases to arbitration. *See e.g. Stewart v. Stearns & Culver Lumber Co.*, 56 Fla. 570, 48 So. 19 (1908) (refusing to enforce an agreement in restraint of trade and stating, at 588, a standard summary of the doctrine of illegality, "The courts will not in general aid either party to enforce an illegal agreement, but will leave the parties where they place themselves with reference to such illegal agreement, except where the law or public policy requires action by the courts, or where the parties are not in pari delicto, and perhaps in other cases not pertinent here."); *Wechsler v. Novak*, 157 Fla. 703, 26 So. 2d 884 (1946) (refusing to overturn a judgment for the defendants where the plaintiff was said to have been retained to perform illegal services of corruptly influencing public officials and noting that "the general right to contract is subject to the limitation that the agreement must not violate the Federal or State Constitutions or state statutes..." and also stating that "[t]he doctrine relating to illegal agreements is founded on a regard for the public welfare and therefore each contract must have a lawful purpose."); and *Castro v. Sangles*, 637 So. 2d 989 (Fla. 3d DCA 1994) (refusing aid of the court to enforce a construction deal when the owner made a sworn and knowingly false statement that he was the "owner-builder" to the county permit authorities, when in fact he hired an unlicensed contractor in violation of a Florida statute).

Although the states vary in their approaches to illegality, the approach of Florida is one of the common variants and of longest pedigree. The RESTATEMENT (SECOND) OF CONTRACTS avoids the concept of illegality, preferring to treat illegality under the doctrine of unenforceability on grounds of public policy. *See* Vol. 2 at 5 (Introductory Note to Topic 1, Unenforceability in General, contained in Chapter 8 on "Unenforceability on Grounds of Public Policy"). Despite this position of the RESTATEMENT (SECOND), many courts continue to use the longstanding common law concepts of bargains void as illegal or void as against public policy. *See* Richard A. Lord, 5 WILLISTON ON CONTRACTS § 12.1 (4th ed., updated as of July 2004) (noting that the RESTATEMENT (SECOND) eschews use of the doctrine of illegality, but also stating that the courts "continue to speak in terms of illegality, and continue to search for classifications of which bargains will be held to be void for illegality or void as against public policy.")[7]

Thus, the RESTATEMENT (SECOND) is not descriptive of the common law of Florida and other states that continue to treat illegality as undermining the existence of a contract. The original RESTATEMENT OF CONTRACTS better reflects this continuing tradition. It includes a long chapter on "Illegal Bargains." *See id.* Vol. II, 982 et seq. By calling them "illegal bargains," the first RESTATEMENT avoids treating illegal transactions as contracts in cases where they are not enforced at all. The categories of illegality addressed by the RESTATEMENT are many, including bargains in restraint of

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[7] In the related doctrine of contracts against public policy, not raised in this case, courts sometimes divide the transaction into enforceable and unenforceable parts, but not where the public policy problem affects "the entire agreement" and makes it "an integrated scheme to contravene public policy." E. Allan Farnsworth, CONTRACTS 345 (4th Ed. 2004).

trade, wagers, usury, bargains tending to obstruct the administration of justice, bargains in violation of public or fiduciary duty, bargains tending to defraud or injure third persons, bargains prohibited by statute, bargains concerning domestic relations, and miscellaneous illegal bargains. *Id.* at Sections 513-597. Generalizations about all these forms of illegality are difficult, but the first RESTATEMENT did attempt to state principles about when illegal bargains are not legally enforced (and thus are not contracts under the longstanding definition that a promise or set of promises that is not legally enforced is not a contract). This first RESTATEMENT comment provides a good summary of principles:

> The statement that all illegal bargains are void is not wholly accurate. It is true that many such bargains are entirely without effect on the legal relations of the parties....When relief is denied it is because the plaintiff is a wrongdoer, and to such a person the law denies relief. Courts do not wish to aid a man who founds his cause of action upon his own immoral or illegal act. If from the plaintiff's own statement or otherwise it appears that the bargain forming the basis of the action is opposed to public policy or transgresses statutory prohibitions, the courts ordinarily give him no assistance. *See id.*, Vol. II, Section 598, cmt. a.

Another principle from the first RESTATEMENT is that an "unessential" illegal provision does not bar enforcement of the bargain. *Id.*, Section 603. A provision is unessential if it can be disregarded without defeating the "primary purpose" of the

transaction and if the rest of the contract can be performed with omission of the illegal portion. Thus, contrary to assertions of *amici* of Buckeye, the doctrine of illegality does not envision that a trivial illegality peripheral to the primary purpose of a deal makes the entire bargain *void ab initio* as a contract. In a criminal loansharking transaction, however, the loan at a very high rate of interest, in violation of criminal statutes, is the central purpose of the bargain.

The first RESTATEMENT contemplates that a centrally illegal bargain is void as a contract, meaning it is not given any legal effect as such, in order to discourage immoral or illegal acts that are against public policy. Furthermore, denying legal recognition to any aspect of an illegal deal makes "an important symbolic statement." Stewart Macaulay et al., CONTRACTS: LAW IN ACTION, Vol. I, at 511 (2d Ed. 2003). Of course, even when the existence of a contract is not recognized, the underlying behavior is still recognized and can be the basis of criminal prosecution or non-contractual civil remedies, particularly on behalf of the victim of criminal behavior, where use of a restitution cause of action or statutory remedies may be appropriate. For example, the first RESTATEMENT recognizes a general restitution principle that a party not in pari delicto in an illegal bargain can repudiate the bargain and recover any performance under it, not on the contract but in restitution. RESTATEMENT, Section 604.

The longstanding doctrine that certain illegal bargains are denied recognition as contracts is not an invention to attempt to evade the FAA; the doctrine is not directed specifically at arbitration but is applicable to the transaction as a whole. When illegal bargains are void as contracts, no clause is given

legal effect. As Lord Mansfield made clear in 1775, the policy is one of protecting the integrity of courts by avoiding having them give aid to a wrongdoer. *See Holman v. Johnson*, 1 Cowp. at 373. The doctrine protects not only courts as institutions, but also the rule of law. It seems highly unlikely that Congress intended to preempt this venerable doctrine when it enacted the FAA.

Court enforcement of any clause of a quintessentially criminal bargain validates the crime, and this is why some states choose the course of finding no contract at all when the illegality is central to the transaction. *See* RESTATEMENT, Section 603. The idea that centrally illegal bargains are void rather than voidable may seem formal, but in reality it is not. When a bargain is void for illegality, neither party can enforce it. This expresses the state's public policy and preserves the reputation as well as the integrity of the courts. On the other hand, when a bargain is merely voidable, an injured party can choose to affirm it and claim its benefits. Voidability protects one party against another, whereas voidness expresses the state's public policy that the type of transaction is noxious, should not be made at all, and therefore should be denied existence as a contract.

It is among the obvious possible policy reasons for a criminal loansharking statute that a person taking out a loan at a literally criminal rate of interest is not acting rationally and free from economic duress and thus cannot be said to have validly agreed to anything. Furthermore, given that the test for a finding of agreement to a contract is objective (manifestation of assent), a loanshark is not misled by its victim into thinking there is

valid agreement. This reasoning helps to explain the Florida common law conclusion of "no contract."

Particularly in cases of central and pervasive criminal illegality, it makes common sense to say that the bargain falls as a whole because criminals do not get valid agreement to anything and should not be able to enlist the courts to help them. If an arbitration clause in a written document were enough to guarantee court assistance, one could imagine a parade of horribles, with courts forced to aid alleged murderers, drug dealers, robbers, traders in human organs, videotapers of dressing rooms, dealers in dead bodies, sellers of trade secrets, or–as alleged in this case–loansharks. In appropriate cases, courts should be able to put a stop to contractual and judicial validation of criminal behavior by first deciding the question whether there is illegality that prevents valid making of a contract. Otherwise, courts as institutions would lose their integrity, dignity and reputations. This is the insight behind the common law doctrine of illegality making a bargain *void ab initio* as a contract. The first question for the Florida state court in this case is whether the transactions in question are contracts at all.

CONCLUSION

A state court asked to compel arbitration under the FAA must first decide a state law issue of illegality that determines whether a contract exists. The FAA only operates to validate an arbitration clause if FAA Section 2 threshold requirements are met. In this case, the Section 2 issue is whether there is a "contract." Therefore, the Florida Supreme Court reached the correct disposition of the case when it remanded it to the state

trial court to decide whether the allegedly criminal loansharking transactions were *void ab initio* as contracts.

Respectfully submitted,

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September 21, 2005

No. 04-1264

Supreme Court, U.S.
FILED
SEP 23 2005
OFFICE OF THE CLERK

IN THE

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BUCKEYE CHECK CASHING, INC.,
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JOHN CARDEGNA, *et al.*,
Respondents.

On Writ of Certiorari to the Supreme Court of Florida

BRIEF *AMICI CURIAE* OF THE NATIONAL ASSOCIATION OF CONSUMER ADVOCATES, THE U.S. PUBLIC INTEREST RESEARCH GROUP, AND THE CENTER FOR RESPONSIBLE LENDING IN SUPPORT OF RESPONDENTS

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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IN THE

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INTEREST OF *AMICI CURIAE* [1]

The National Association of Consumer Advocates ("NACA") is a nationwide non-profit corporation whose over 1000 members are private and public sector attorneys, law professors, law students, and non-attorney consumer advo-

[1] A letter of consent from each of the parties has been filed with the Clerk of the Court. Although counsel for the respondents is an officer and a member of the National Association of Consumer Advocates, no counsel for a party authored this brief in whole or in part, and no person or entity other than *amici curiae* made a monetary contribution to the preparation or submission of this brief.

cates. NACA members' primary interest is the protection and representation of consumers. NACA's mission is to promote justice for all consumers and to provide a forum for information sharing among consumer advocates across the country. From its inception, NACA has focused on issues concerning abusive and fraudulent practices by businesses that provide financial and credit-related services.

NACA's members, as representatives of borrowers and other consumers across this nation, have witnessed first-hand the negative impact that pre-dispute, binding mandatory arbitration clauses have on the ability of average citizens to obtain justice. NACA is concerned that consumers will not be able to challenge illegal contracts effectively if the Florida Supreme Court's ruling is reversed.

The U.S. Public Interest Research Group ("U.S. PIRG") serves as the national advocacy office and association for state PIRGs, which are non-profit, non-partisan public interest advocacy organizations with over 500,000 members around the country. The state PIRGs and U.S. PIRG have a long history of advocacy on behalf of consumer rights in the financial and legal marketplace, and have produced numerous reports and studies documenting unfair practices of payday lenders, rent-to-own stores, and other predatory lenders. The PIRGs are also founding members of a national network of organizations seeking to ban the use of binding mandatory arbitration in consumer contracts.

The Center for Responsible Lending ("CRL") is dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. A non-profit, non-partisan research and policy organization, CRL promotes responsible lending practices and access to fair terms of credit for low-wealth families. CRL's experience with lending issues is enhanced by its affiliation with Self-Help, one of the nation's largest community development financial institutions.

CRL is interested in this case because a victory for the petitioner would make it even more difficult for consumers to challenge illegal lending practices, such as the payday loan violations alleged in this case. CRL views illegal payday lending as both a consumer issue and a civil rights issue. Research by CRL has shown that payday loans trap borrowers in a cycle of debt and that North Carolina payday lending storefronts are disproportionately located in African-American neighborhoods. Uriah King et al., CRL, Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina (2005), *available at* http://www.responsiblelending.org/pdfs/PaydayRace-Mar05.pdf; Keith Ernst et al., CRL, Quantifying the Economic Cost of Predatory Payday Lending 2 (2003), *available at* http://www.responsiblelending.org/pdfs/PaydayStudy-Dec03.pdf (finding that 91% of payday loans are made to borrowers with 5 or more payday loans per year and that borrowers, on average, receive 8 to 13 payday loans per year).

In addition to studying payday loans, CRL has worked on a number of other loan products affected by binding mandatory arbitration. Many lenders routinely insert binding mandatory arbitration clauses into contracts for mortgage loans, credit cards, refund anticipation loans, car title loans, and other products.

NACA, U.S. PIRG, and CRL share the concerns about the payday lending industry expressed by *amicus curiae* AARP and others. This separate brief is submitted to respond to assertions made by the petitioner and various *amici curiae* regarding binding mandatory arbitration and its effects on consumers.

SUMMARY OF ARGUMENT

Several *amici curiae* supporting the petitioner describe arbitration as an inexpensive and efficient method of resolving claims and assert that arbitration favors consumers. This

characterization is at odds with the reality experienced by consumers forced into binding mandatory arbitration.

If courts are prohibited from adjudicating the legality of contracts that contain mandatory arbitration clauses, arbitration costs will deter many consumers from challenging illegal contracts. Fees that can be high and unpredictable, unreliable fee waiver programs, inconvenient forum requirements, and consumers' inability to share costs combine to make arbitration much more expensive for many consumers than proceeding in court. Arbitration conducted pursuant to a typical mandatory arbitration clause also lacks many of the natural efficiencies that our judicial system derives from its class action rules, transparency, and reliance on precedent. The ways in which arbitral proceedings expedite claims, such as not requiring a statement of the arbitrator's reasoning, do not result in real efficiency, but instead make it even more important that courts rather than arbitrators decide whether contracts are illegal or unenforceable under state law.

Far from favoring consumers, binding mandatory arbitration makes it extremely difficult for consumers to challenge illegal contracts for a number of reasons, including stringent secrecy requirements, prohibitions on class actions, and limits on discovery and available remedies. Companies may also benefit as repeat players in arbitration proceedings. These aspects of arbitration deter many consumers from filing and make it difficult for those who do pursue claims to prevail. The study by Ernst & Young LLP that several *amici curiae* cite to support their argument that arbitration favors consumers suffers from serious deficiencies, including the use of flawed measures to determine when consumers prevailed and the very small number of responses Ernst & Young received to its phone survey. Because so many obstacles prevent successful challenges to illegal contracts in binding mandatory arbitration proceedings, consumers should have access to the courts to bring such challenges.

In response to concerns that arbitrators will enforce illegal contracts, the petitioner and Financial Service Centers of America, Inc. ("FiSCA") allude to post-arbitration judicial review and police powers respectively. These lines of argument fail to acknowledge how difficult it is under current law to vacate an arbitral decision and the critical role that Congress and state legislatures intend private enforcement to play in enforcing consumer protection laws.

ARGUMENT

I. ARBITRATION COSTS WILL PREVENT MANY CONSUMERS FROM CHALLENGING ILLEGAL CONTRACTS IF THE PETITIONER PREVAILS.

The American Bankers Association, the Community Financial Services Association of America ("CFSA"), and FiSCA characterize arbitration in their *amicus curiae* briefs as an inexpensive way to resolve claims. (American Bankers Association Br. 1-2; CFSA Br. 2; FiSCA Br. 6.) In fact, arbitration costs can be vastly higher for some consumers than the costs of filing a court action because of large fees, discretion associated with fee waiver programs, requirements that arbitration take place in a distant forum, consumers' inability to share costs through class actions, and the practical difficulty of challenging arbitration costs in court.

While arbitration companies have imposed caps on fees that consumers must pay in some arbitration proceedings, the caps often have significant exceptions. For example, the American Arbitration Association ("AAA") retains the "discretion to apply or not to apply" the provisions of its Supplementary Procedures for Consumer-Related Disputes, which include its maximums on consumer fees for consumer claims. AAA, Supplementary Procedures for Consumer-Related Disputes (2005), *available at* http://www.adr.org/sp.asp?id=22014. These maximums also do not apply to claims

for more than $75,000 or claims seeking non-monetary relief, such as injunctions, which are often important in consumer protection actions. *Id.* (setting a cap on the consumer portion of the arbitrator's fees at $125 for claims less than $10,000 and at $375 for claims between $10,000 and $75,000). Consumers with larger claims or non-monetary claims must pay administrative fees based on AAA's much more expensive commercial schedule and must deposit half of the arbitrator's compensation in advance. *Id.*; AAA, Commercial Arbitration Rules and Mediation Procedures (2005), *available at* http://www.adr.org/sp.asp?id=22002 (starting fees at a $1,800 initial filing fee plus a $750 case service fee for commercial claims between $75,000 and $150,000 and requiring a $3,250 initial filing fee and a $1,250 case service fee for non-monetary claims).

Like AAA, the National Arbitration Forum ("NAF") charges consumers higher fees for larger claims, a practice that may discourage consumers from claiming the full amount of their loss. NAF, Fee Schedule 9-13 (2005), *available at* http://www.arb-forum.com/programs/code_new/2005_fees.pdf. Although NAF caps filing and participatory hearing fees for smaller claims at $250, these caps do not apply if the claim exceeds $74,999 or if the parties have agreed otherwise. *Id.* at 4, 9-13. Above and beyond the filing and participatory hearing charges, NAF imposes additional fees as the arbitral proceedings progress, such as fees to process objections or to file a post-hearing memorandum, making it very difficult to predict the total cost of arbitration. *Id.* at 5-13 (describing several types of fees and stating that "[t]he Forum establishes all other fees").[2]

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[2] Even if an arbitration provider has a cap on fees that protects consumers from the high costs of arbitration at the time of filing, it may nevertheless permit the infliction of excessive costs on consumers who do not prevail. For example, while consumers who arbitrate through JAMS are required to pay only $125 if they initiate arbitration, a consumer who

Some arbitration providers charge a separate, significant fee for the arbitrator's time, an additional expense that has no parallel in the court system. Since arbitrators who work for the same arbitration provider can charge different rates, consumers subject to such charges may have to pay initial filing fees just to learn what the hourly rate will be for the arbitrator who may hear their claim. *See Ting v. AT&T*, 182 F. Supp. 2d 902, 916-17 (N.D. Ca. 2002), *aff'd in relevant part, rev'd in part*, 319 F.3d 1126 (9th Cir.), *cert. denied*, 540 U.S. 811 (2003). In a random sampling of AAA commercial arbitrators in northern California, the average arbitrator compensation ranged from $600 to $3,850 per day. *Id.* at 917; *see also Phillips v. Assocs. Home Equity Servs., Inc.*, 179 F. Supp. 2d 840, 846 (N.D. Ill. 2001) (noting arbitrator fees ranging from $750 to $5,000 per day). A 2004 study by the California Dispute Resolution Institute considered fee data from over 1,400 arbitration cases and determined the average total arbitrator fee was $2,256. California Dispute Resolution Institute, Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure 21 (2004), *available at* http://www.mediate.com/cdri/cdri_print_Aug_6.pdf. The possibility of incurring all or part of such a large expense may deter consumers from filing claims, especially when payment is required in advance.[3]

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does not prevail in a JAMS arbitration may be required to pay the fees and costs incurred by the opposing party unless protected by California law. JAMS, Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness (2005), *available at* http://www.jamsadr.com/rules/consumer_min_std.asp.

[3] While there are arbitrators who work *pro bono*, such services are typically limited in scope and availability. *See, e.g.*, AAA, Administrative Fee Waivers and Pro Bono Arbitrators Services (2003), *available at* http://www.adr.org/sp.asp?id=22040 (indicating that *pro bono* arbitrator services may be requested for one-day hearings, but are not guaranteed).

A 2002 study by Public Citizen of the three largest arbitration providers found that arbitration forum costs could be up to five thousand percent higher than court fees. Public Citizen, The Costs of Arbitration 2, 43 (2002), *available at* http://www.citizen.org/documents/ACF110A.PDF. The study also found vastly higher arbitration costs for certain types of claims brought under a pre-dispute clause than for similar claims submitted on a post-dispute basis. *Id.* at 2, 71. The study noted that there is little incentive for arbitration companies to cut costs for claims arbitrated pursuant to a pre-dispute clause, as opposed to a post-dispute arbitration agreement, because companies that insert pre-dispute clauses into their contracts want to limit the number of claims filed. *Id.* at 2.

Despite reductions in certain arbitration fees since 2002, the concerns expressed in the Public Citizen report remain for many consumers. The table below compares the cost that a consumer might face in arbitrating an $80,000 claim through a three-hour NAF participatory hearing to the cost of litigating the same claim in federal court.

Arbitration versus Court:
Sample Costs for $80,000 Consumer Claim

Item	Arbitration	Court
Filing fee	$300	$250
Commencement fee	$300	$0
Administrative fee	$1,000	$0
Requests for a subpoena, a discovery order, and an amendment	$675	$0
Participatory hearing (3 hours)	$1,500	$0
Post-hearing memorandum	$100	$0
Written findings of fact, conclusions of law, or reasons for award	$1,500	$0
Request for a dispositive order	$500	$0
Total	**$5,875**	**$250**

See NAF, Fee Schedule, *supra*, at 9-13; 28 U.S.C. § 1914.

Although many arbitration providers have fee waiver programs, these programs can be discretionary and unpredictable. For example, even if a consumer provides required financial information and meets AAA's indigency requirement, AAA reserves the right to deny a waiver. *See* AAA, Administrative Fee Waivers and Pro Bono Arbitrators Services (2003), *available at* http://www.adr.org/sp.asp?id=22040. Fee waivers also may not be available for all types of claims and may not cover some arbitration expenses. NAF, for instance, only permits waivers for claims of less than $75,000 and does not waive the fees that it charges for written findings of fact, conclusions of law, or reasons for the award. *See* NAF, Code of Procedure 2, 40 (2005), *available at* http://www.arb-forum.com/programs/code_new/2005_code.pdf; Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 Law & Contemp. Probs. 133, 144 (2004).

Clauses that require arbitrations to take place in a distant forum can further increase the costs for consumers. Many binding mandatory arbitration clauses include a provision specifying a particular location where the arbitration hearing must be held, which, if enforced, may result in significant travel expenses that would not be necessary to litigate a case in court. *See* Budnitz, *The High Cost of Mandatory Consumer Arbitration*, *supra*, at 149-50.

These expenses are particularly burdensome because of restrictions on class actions and joinder in arbitration proceedings. Class actions and consolidation of claims permit consumers to leverage resources to litigate claims that would otherwise be cost prohibitive. As the Court has recognized:

> "The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry

> potential recoveries into something worth someone's (usually an attorney's) labor."

AmChem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)); *see also Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 338-39 (1980); *Ting v. AT&T*, 182 F. Supp. 2d at 930-31. Many consumer arbitration clauses specifically prohibit consolidation of claims or class actions, and even where an arbitration clause is silent, class actions are often not permitted. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, *supra*, at 142-43, 149. Without the ability to proceed as a class, consumers cannot share expenses and may not be able to obtain necessary legal representation.[4]

Consumers who cannot afford arbitration and its associated expenses face an uphill battle to challenge arbitration costs in court. The onus is on the consumer to show the likelihood of incurring costs that are prohibitively expensive. *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 92 (2000). Given the uncertainties about what the fees will be and the lack of clarity regarding when expenses are considered prohibitive, many consumers are unable to make such a showing and abandon their claims. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, *supra*, at 150-56. If the Court rules that consumers cannot challenge illegal contracts as void *ab initio* in court, the costs associated with arbitration and the

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[4] While FiSCA asserts that "[i]nformal consumer arbitration procedures do not require representation of a respondent business by lawyers" (FiSCA Br. 15), a recent California Dispute Resolute Institute survey suggests that consumers generally do require representation when they are parties to arbitration. In 79% of the 2,175 arbitration cases studied, the consumer party retained legal counsel. California Dispute Resolution Institute, *supra*, at 26. This is not surprising given the complex legal questions often present in consumer matters and the mismatch in sophistication between the business and the typical consumer in such arbitrations.

practical difficulty of challenging those costs may prevent many consumers from disputing such contracts at all.

II. ARBITRATION IS NOT AN EFFICIENT WAY TO RESOLVE CLAIMS THAT CONTRACTS ARE ILLEGAL.

The American Bankers Association states that upholding the decision of the Florida Supreme Court would "divert numerous disputes into the more expensive and less efficient court system." (American Bankers Association Br. 2.) According to CFSA, "[g]iven the small amount of a payday advance, arbitration is particularly well-suited to resolve disputes." (CFSA Br. 9.) Binding mandatory arbitration, however, actually creates many of the inefficiencies that these organizations claim to fear, especially when the issue in question is the legality of a form contract used in thousands of transactions. Arbitration proceedings conducted under a typical mandatory arbitration clause lack many of the natural efficiencies of the judicial system, including the economy of aggregating class-wide claims and the benefits of transparency and precedent.

The notion that companies favor arbitration for efficiency reasons is belied by the restrictions on class-wide arbitrations described above. This refusal to address like claims together is the antithesis of efficiency and prevents consumers from using their claims to obtain relief for all victims of a particular violation at once. *See Am. Pipe & Const. Co. v. Utah*, 414 U.S. 538, 553 (1974) (recognizing "efficiency and economy of litigation" as "a principal purpose of the [class action] procedure").

Another inefficiency of arbitration is the fact that arbitrators must resolve the same issues again and again as if for the first time, without making any contribution to the development of the law. In marked contrast to our open court system, secrecy shrouds the arbitral process. As Judge Diane P. Wood explained in an article in 2003, "[e]verything, from the

content of the demand for arbitration, through the materials submitted before the hearing, the hearing, and the ultimate reasons for the disposition, can be, and often is, maintained in absolute confidence." Diane P. Wood, *The Brave New World of Arbitration*, 31 Cap. U. L. Rev. 383, 397 (2003). Arbitrators are often not required to produce findings of fact or conclusions of law, and even the parties may not be privy to the reasoning behind an arbitrator's decision. *See, e.g., United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 598 (1960) ("Arbitrators have no obligation to the court to give their reasons for an award."); AAA, Commercial Arbitration Rules and Mediation Procedures, *supra*, at § R-42(b) ("The arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate."). Moreover, "arbitrators' decisions are not intended to have precedential effect even in arbitration (unless given that effect by contract)." *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*, 136 F.3d 537, 543 (7th Cir. 1998) (citing cases). As a result, arbitrators are unable to build upon or benefit from prior arbitral decisions or reasoning.

To the extent that arbitration does expedite individual claims, it is primarily because arbitration denies participants necessary discovery and other litigation process that consumers require to develop their claims. For example, as Judge Wood explained in her article, "the arbitral rules used often place strict limits on document discovery, the number of depositions that will be permitted, and the matters that may be explored." Wood, *supra*, at 397. The so-called "efficiency" of this stripped-down procedure is not the way to resolve a claim that a contract is illegal under state or federal law.[5]

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[5] The American Bankers Association's assertion that a trip to the courthouse to determine the legality of a contract would render the arbitra-

III. ARBITRATION IS NOT A FAVORABLE FORUM FOR CONSUMERS TO CHALLENGE ILLEGAL CONTRACTS.

A. The Rules that Govern Binding Mandatory Arbitration Are Skewed in Ways that Impede Consumer Challenges.

In addition to the cost and efficiency concerns raised above, arbitration is generally *not* a favorable forum for consumers to challenge the illegality of a contract. In its brief, FiSCA suggests that the threat of unconscionability or other challenges ensures that mandatory arbitration clauses and procedures are fair. (FiSCA Br. 14-15.) What FiSCA generously characterizes as "[m]eticulous efforts to assure fairness" (*id.* at 14) appear instead to be painstaking attempts to draft clauses that favor corporate entities as much as possible but narrowly evade judicial invalidation. The number of arbitration clauses that have successfully been challenged as unconscionable is hardly proof that the remaining clauses are fair or consumer-friendly.[6]

Quite the contrary, the rules that govern binding mandatory arbitration are often skewed in ways that make it very difficult for consumers to challenge an illegal contract. The limits that binding mandatory arbitration frequently places on discovery and on the evidence that may be introduced naturally disadvantage consumers, who may need to establish a

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tion clause "effectively meaningless" is without merit. (American Bankers Association Br. 16.) In fact, arbitration parties frequently have to resort to the courts because of the arbitrator's limited powers. For example, a party to arbitration may need to file a court action to compel a third-party witness to attend or to confirm an arbitration award. *See* 9 U.S.C. §§ 7, 9.

[6] One of the sources cited by the Chamber of Commerce found that courts struck down over 80 arbitration contracts as unconscionable in 2002 and 2003. Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 194 (2004), *cited in* Chamber of Commerce Br. 15 n.15.

pattern or practice or make a similar showing to prove their claims. Access to discovery is especially important for consumers in disputes with financial institutions because "the institution or third parties have within their exclusive possession the critical information and documents the consumer needs to prove the case." Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 Ohio St. J. on Disp. Resol. 267, 283-84 (1995). The secrecy surrounding arbitrations also disfavors consumers by concealing evidence, findings, and legal conclusions that might inform other victims of their rights or assist them in developing their claims. *See, e.g., Ting v. AT&T*, 319 F.3d 1126, 1152 (9th Cir.), *cert. denied*, 540 U.S. 811 (2003).[7]

Companies frequently draft arbitration clauses to limit or prevent certain types of traditional monetary damages that predominantly benefit consumers and are central to effective law enforcement, including punitive damages and certain types of compensatory damages. *See* Budnitz, *The High Cost of Mandatory Consumer Arbitration*, *supra*, at 137, 141 & n.50.[8] Arbitration clauses may also include other one-sided provisions that benefit only companies, not consumers—for example, excluding from coverage certain types of claims that only companies would bring. *See, e.g.*, NAF, Drafting Mediation and Arbitration Clauses: Practical Tips and Sample

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[7] Contrary to FiSCA's assertion that "[r]ational litigants would shun the invocation of the [Federal Arbitration Act] when it would entail the disclosure of unseemly practices" (FiSCA Br. 14 n.9), the arbitral forum is *precisely* where a party engaged in illegal activity would want claims against it to be heard.

[8] Punitive damages are designed to deter both the company that is a party and other businesses from engaging in illegal conduct. Together with the secrecy of arbitration proceedings, the absence of punitive damages can make it not only feasible, but even profitable, for companies to write off what few losses they might have in arbitration as a cost of doing business, without altering their practices.

Language 11 (2005), *available at* http://www.arb-forum.com/resources/white_papers/05clauses.pdf (providing language for a mortgage agreement arbitration clause that would preserve the right to proceed in court to exercise "all rights to foreclose against any real or personal property or other security by exercising a power of sale granted under Loan Documents or under applicable law or by judicial foreclosure and sale, including a proceeding to confirm the sale"); *Little v. Auto Stiegler, Inc.*, 63 P.3d 979, 983-85 (Cal.) (discussing an "unconscionably one-sided" arbitral appeal provision in an employer-mandated arbitration clause that only permitted appeals of awards that exceeded $50,000), *cert. denied*, 540 U.S. 818 (2003). As noted above, prohibitions on class actions also prevent many consumers from filing at all, particularly in cases where each individual's stake may be relatively small.

In addition to industry-favoring rules, companies may benefit from a repeat player effect in consumer arbitrations because they may be involved in hundreds, thousands, or even tens of thousands of arbitrations, while each consumer claimant will likely participate in only one. *See generally Ting*, 319 F.3d at 1152 (noting the "advantages [for AT&T] inherent in being a repeat player"); *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1476 (D.C. Cir. 1997) (discussing the advantage that an employer gains as a repeat player in cases involving mandatory arbitration of individual statutory claims); Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 Emp. Rts. & Emp. Pol'y J. 189, 206, 213 (1997) (finding a repeat player effect in a study of data from 270 AAA arbitration cases decided in 1993 and 1994 under rules then in effect). First USA, N.A. is an example of a repeat player. Between 1998 and 2000, it filed over 51,000 claims against cardmembers with NAF. Caroline E. Mayer, *Win Some, Lose Rarely?: Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000, at E1. The cardmember prevailed in just 87 of the 19,705 awards made by

the year 2000, while First USA prevailed in 19,618 or over 99.5%. *Id.* Arbitration providers and arbitrators also may have an economic interest in being selected by companies for future cases. *See, e.g., Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671, 678-79 (Ct. App. 2002) ("The fact an employer repeatedly appears before the same group of arbitrators conveys distinct advantages over the individual employee. These advantages include knowledge of the arbitrators' temperaments, procedural preferences, styles and the like and the arbitrators' cultivation of further business by taking a 'split the difference' approach to damages."); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637, 685 (1996) ("[A]rbitrators may be consciously or unconsciously influenced by the fact that the company, rather than the consumer, is a potential source of repeat business."). These considerations combine to make it very difficult for consumers to challenge illegal contracts in binding mandatory arbitration proceedings.

B. The Ernst & Young Study Does Not Prove that Arbitration Results Favor Consumers.

Due to the secrecy surrounding arbitral proceedings, consumer advocates and academics have had great difficulty gaining access to arbitration data to conduct studies. Although a California law enacted in 2002 requires public disclosure of certain arbitration information, some companies, including NAF, have failed to comply fully. *See* Cal. Civ. Proc. Code § 1281.96; *Klussman v. Cross-Country Bank*, No. 2001-026688, slip op. at 9 (Cal. Super. Ct. Oct. 28, 2004) ("By way of dicta, the Court notes that the arbitration provision may also be unenforceable because NAF does not comply with C.C.P. 1281.96."); California Dispute Resolution Institute, *supra*, at 27-32. Rather than facilitating truly independent research, industry groups have commissioned their own studies. For example, Wilmer Cutler Pickering

Hale and Dorr LLP engaged Ernst & Young LLP to conduct a study with financial support from the American Bankers Association and the participation of NAF. Ernst & Young LLP, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases 2, 19 (2004), *available at* http://www.arb-forum.com/media/EY_2005.pdf. The American Bankers Association, CFSA, and FiSCA all tout this study in their briefs for the proposition that consumers prevail more often than companies in credit-related arbitration proceedings and that consumers are satisfied with the arbitration process. (American Bankers Association Br. 15-16; CFSA Br. 10; FiSCA Br. 16-17.) On closer examination, however, it is clear that the study does not prove either proposition.

The Ernst & Young study only addresses the arbitral claims that consumers actually filed and fails to consider all of the claims that were *not* filed because of the barriers that consumers face when considering whether to pursue an arbitration claim. In gauging the volume of claims that consumers forego each year, it is telling to compare the number of claims filed by consumers with the number filed by companies *against* consumers. As of the year 2000, First USA had filed over 51,000 NAF claims against cardmembers, while only *four* cardmembers had filed arbitration claims with NAF against First USA. Mayer, *supra*, at E1. Similarly, although NAF administers over 50,000 arbitrations each year, it had only 226 consumer-initiated files for the four-year period from January 2000 to January 2004. NAF, Drafting Mediation and Arbitration Clauses, *supra*, at 15; Ernst & Young, *supra*, at 7.

In light of all the factors that might dissuade consumers from filing arbitration claims and the incredibly small percentage of consumers who proceed to arbitration, one would naturally expect consumers who *do* pursue arbitration claims to have especially strong claims and to prevail in a very high percentage of cases. Even if the Ernst & Young study could

establish that consumers prevail in more than half of the arbitration claims they file, such a showing would not prove that arbitration favors consumers *overall* since many consumers who might have litigated viable claims may be dissuaded from filing an arbitration claim at all.

Moreover, the Ernst & Young study does not prove that consumers in fact prevail more often than businesses in consumer-initiated, credit-related arbitration claims. Ernst & Young used two different flawed measures to determine how many consumers had prevailed. *See* Ernst & Young, *supra*, at 9-10. Under one measure, Ernst & Young treated 117 claims—more than half of the 226 claims studied—as ones in which the consumer prevailed simply because the claims were dismissed at the claimant's request. *Id.* at 9 & n.11, 23. Far from prevailing, many of these consumers likely abandoned their claims due to the high costs, lack of discovery, and other obstacles they faced during the arbitral process.[9] In its other measure, Ernst & Young considered only those claims that proceeded to an arbitration judgment, reducing an already small sample to just 97 claims. *Id.* at 10. Under both measures that it used, Ernst & Young categorized *any* damage award as a case in which the consumer prevailed, without regard to the relative sizes of the individual's claim and the award. *Id.* at 9 n.11. The problem with this approach is obvious: A consumer who seeks $1,000 in damages from a company and obtains only $50 in relief has not prevailed. Because of the flaws in both of the measures that Ernst &

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[9] Of 118 files that were dismissed at the claimant's request, Ernst & Young treated only one as one in which the consumer did not prevail, and in that case did so only because the file explicitly stated that the consumer could not afford to continue. Ernst & Young, *supra*, at 9 & n.11, 23. Ernst & Young acknowledged that its reviewers had to "use their judgment" to determine whether consumers had prevailed in certain cases. *Id.* at 9 n.11. It also admitted that it did not compare its results to the results that consumers obtain in comparable court cases. *Id.* at 6.

Young used to determine who prevailed, *amici curiae*'s assertions that consumers have prevailed in 55% or "close to 80%" of consumer-initiated, credit-related arbitrations are not supported by the study. (American Bankers Association Br. 15-16; CFSA Br. 10; FiSCA Br. 17.)

The Ernst & Young customer satisfaction phone survey also cannot bear the weight that the American Bankers Association, CFSA, and FiSCA place upon it. NAF representatives made the initial contact with each consumer during the survey calls, a fact that likely discouraged people who had negative experiences from participating or responding candidly. *See* Ernst & Young, *supra*, at 19. Additionally, the survey results are based on just 29 responses. *Id.* at 7 & n.9. Phone surveys can introduce an element of bias because phones are not distributed evenly throughout society, and those who cannot be reached by phone may well respond differently than those who can. *See* U.S. Dep't of Commerce, Falling Through the Net: Defining the Digital Divide, at pt. IB (1999), *available at* http://www.ntia.doc.gov/ntiahome/fttn99/contents.html (noting disparities among different demographic groups regarding telephone penetration); Owen T. Thornberry & James T. Massey, *Trends in United States Telephone Coverage Across Time and Subgroups, in Telephone Survey Methodology* (Robert M. Groves et al. eds., Wiley & Sons 1988). This selection bias is of particular concern in the Ernst & Young study because NAF lacked current contact information for 71 consumers, did not reach 64 other consumers, and spoke with 11 consumers who refused to participate in the survey. *See* Ernst & Young, *supra*, at 7 n.9, 11, 18. Given all of the deficiencies in the Ernst & Young study, there is no reason to believe that the 29 people who responded were in any way representative of all consumer arbitration claimants.

IV. POST-ARBITRATION JUDICIAL REVIEW AND PUBLIC ENFORCEMENT AUTHORITY DO NOT OBVIATE THE NEED FOR COURTS TO DETERMINE THE LEGALITY OF CONTRACTS BEFORE ARBITRATION.

A. Vacating an Arbitral Decision Is Very Difficult Under Current Law.

Acknowledging the possibility that an arbitrator could enforce an illegal contract, the petitioner asserts that "[i]f the arbitrators were to exceed their authority, or otherwise manifestly disregard the law, then a court could always vacate their decision." (Pet'r's Br. 18.) This statement fails to acknowledge how difficult it is under current law to vacate an arbitral decision. *See, e.g., Brabham v. A.G. Edwards & Sons Inc.*, 376 F.3d 377, 380 (5th Cir. 2004) (stating that the court's review of an arbitral award is "exceedingly deferential" and that it could "permit vacatur of an arbitration award only on very narrow grounds"); *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 389 (2d Cir. 2003) (stating that review under the doctrine of manifest disregard "is highly deferential to the arbitral award and obtaining judicial relief for arbitrators' manifest disregard of the law is rare").

While 9 U.S.C. § 10(a)(4) permits U.S. courts to vacate an arbitral award "where the arbitrators exceeded their powers," a number of courts have held that this section does not permit review of the correctness of the arbitrator's decision. *See, e.g., DiRussa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 824 (2d. Cir. 1997) ("Our inquiry under § 10(a)(4) . . . focuses on whether the arbitrators had the power, based on the parties' submissions or the arbitration agreement, to reach a certain issue, not whether the arbitrators correctly decided that issue."). Some courts have also held that the fact that an arbitrator made erroneous legal determinations is an insufficient basis to overturn an arbitral award for manifest disre-

gard of the law. *See, e.g., IDS Life Ins. Co. v. Royal Alliance Assocs., Inc.*, 266 F.3d 645, 650 (7th Cir. 2001) ("[N]either error nor clear error nor even gross error is a ground for vacating an award."); *Montes v. Shearson Lehman Bros.*, 128 F.3d 1456, 1461 (11th Cir. 1997) ("An arbitration board that incorrectly interprets the law has not manifestly disregarded it. It has simply made a legal mistake."); *cf. Moncharsch v. Heily & Blase*, 832 P.2d 899, 904 (Cal. 1992) ("[I]t is the general rule that, with narrow exceptions, an arbitrator's decision cannot be reviewed for errors of fact or law.").

Some courts of appeals have applied a standard that is extraordinarily difficult to surmount before vacating an award for manifest disregard of the law: they require proof that the arbitrator knew the relevant law yet chose not to apply it. *See, e.g., Duferco Int'l Steel Trading*, 333 F.3d at 389 ("A party seeking vacatur bears the burden of proving that the arbitrators were fully aware of the existence of a clearly defined governing legal principle, but refused to apply it, in effect, ignoring it."); *Montes*, 128 F.3d at 1461. This standard is even more difficult to meet because many arbitrators do not produce findings of fact or conclusions of law or state their reasoning. The extreme deference given to arbitrators' decisions means that post-arbitration judicial review is not a cure for arbitrators' misinterpretations of the law. Accordingly, it is critical that parties be permitted to challenge the legality of a contract that contains an arbitration provision *before* claims are arbitrated.

B. Public Enforcement Authority Alone Will Not Ensure Effective Enforcement of Consumer Protection Laws.

FiSCA asserts that "[t]he result of a decision in a simple dispute between private parties hardly can be said to imperil statewide substantive law" and argues that police powers can cure any wrongs resulting from arbitrators' enforcement of illegal contracts. (FiSCA Br. 11-12, 18-20.) These argu-

ments overlook the central role that Congress and state legislatures intended private parties to play in developing and enforcing consumer protection law.

It is well recognized that Congress intended the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, and a number of other consumer protection statutes to be enforced by private litigants. *See, e.g., Postow v. OBA Fed. Sav. & Loan Ass'n*, 627 F.2d 1370, 1387 (D.C. Cir. 1980) (noting that the Truth in Lending Act was "specifically designed by Congress to be enforced through private citizen suits"). Likewise, in enacting state consumer protection laws, state legislatures have created private rights of action with the expectation that consumer suits would assist in developing and enforcing the law. *See, e.g., Presidential Leasing, Inc. v. Krout*, 896 So. 2d 938, 941-42 (Fla. Dist. Ct. App. 2005) (declining to enforce an arbitration clause found to be an "evisceration of the consumer legislation" because the clause frustrated the purposes behind the prevailing party attorney fee provision of the Florida Deceptive and Unfair Trade Practices Act and discouraged the individual enforcement actions the act was intended to facilitate); *Equitable Life Leasing Corp. v. Abbick*, 757 P.2d 304, 307 (Kan. 1988) (quoting Kansas statutory comment that states that the Kansas legislature provided for civil penalties under the Kansas Consumer Protection Act "to encourage enforcement of the act by a consumer acting as his own 'private attorney general'"). This private enforcement through the courts is absolutely critical to complement efforts by state and federal authorities, which simply do not have the resources that would be necessary to pursue all illegal consumer contracts or even a sizeable fraction thereof. Moreover, diverting all challenges to the legality of contracts to the "black box" that is arbitration would undermine government enforcement efforts by depriving agencies of important information as to which companies' practices are generating a common pattern of consumer complaints.

Because of the real-world limitations on public resources and all of the problems with binding mandatory arbitration discussed above, preventing consumers from challenging illegal contracts in court would impede the enforcement of important state and federal consumer protection laws.

CONCLUSION

For the foregoing reasons, the judgment of the Florida Supreme Court should be affirmed.

Respectfully submitted,

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September 23, 2005

Supreme Court, U.S.
FILED
AUG 12 2005
OFFICE OF THE CLERK

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,
Petitioner,

v.

JOHN CARDEGNA AND DONNA REUTER,
Respondents.

On Writ of Certiorari
to the Supreme Court of Florida

BRIEF OF AMICUS CURIAE THEIS RESEARCH, INC., IN SUPPORT OF NO PARTY ON THE MERITS

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INTRODUCTION

Congress never intended the Federal Arbitration Act to be a Trojan horse to assault the citadel of police powers vested in the states. The FAA is not a general federal license—and enforcement mechanism—for private parties to contract in violation of state law. The FAA does not authorize unlawful conduct, even if one enlists an arbitrator as an accessory after the fact.

The FAA does not authorize courts to confirm arbitration awards that derive from unlawful contracts. Instead, 9 U.S.C. § 2 requires that courts uphold and enforce law applicable to contracts generally, and 9 U.S.C. § 10 requires that courts vacate awards issued by arbitrators who act without power conferred by a valid contract.

INTERESTS OF THE AMICUS CURIAE[1]

Amicus curiae Theis Research, Inc. (Theis, pronounced "Tice") is the petitioner in *Theis Research, Inc. v. Brown & Bain*, No. 04-1566. The petition for a writ of certiorari in that case is pending before the Court as of the submission of this brief.

The law firm of Brown & Bain (B&B, respondent in No. 04-1566) previously represented Theis in patent litigation that went awry. The representation primarily

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[1] This brief is submitted pursuant to the general consent to the filing of amicus briefs, filed by each party on August 1, 2005. This brief has not been authored, in whole or in part, by counsel for a party in this case (No. 04-1264). No monetary contribution to its preparation or submission has been made by any person or entity other than Theis Research, Inc., its counsel, and Success at Last LLC, a non-equity investor in Theis.

involved litigation in the Northern District of California. B&B's legal services agreement provided that it was governed by California law.

To comply with an arbitration clause in B&B's legal services agreement, Theis arbitrated its malpractice claims against B&B. The arbitrator's award gave nothing to either side. Theis thereafter discovered that B&B had violated state conflict-of-interest law because it had simultaneously represented the integrated subsidiary of an adverse party in the patent litigation. By undertaking to represent Theis, B&B had violated California law.[2]

Theis filed a diversity action in the United States District Court for the Northern District of California, seeking to vacate the arbitration award. Theis relied on California law holding unlawful contracts void *ab initio* and nullifying embedded arbitration clauses and resulting awards. Theis cited additional conflicts disclosed in discovery. The district court nevertheless confirmed the arbitration award and held that Theis' conflict of interest claims were barred by claim preclusion doctrine. On appeal, the Ninth Circuit affirmed.

The issues presented by Theis' petition for a writ of certiorari include the following related questions:

- Whether courts—as opposed to arbitrators—shall decide challenges to an underlying agreement with an arbitration clause on the ground that the agreement was void and never existed at the outset, in contrast to agreements that are merely voidable.

[2] B&B concurrently violated a district court rule incorporating the California Rules of Professional Conduct. *See* U.S. District Court, N.D. Cal., Civil Local Rule 11-4.

- Whether, in a diversity case, state law can render an unlawful underlying agreement, including an arbitration clause and a resulting arbitration award, null and void *ab initio*.

Because the Court has determined that the Federal Arbitration Act applies to state court proceedings (*Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984)), the rule applicable to diversity cases would also govern state court cases, such as the present case.

Theis generally supports the position of respondents in this case.

However, Theis also raises considerations that do not appear to advance respondents' position. Theis discusses below the approach that has been taken by the California courts, which distinguishes unlawfulness of the underlying contract as a whole versus unlawfulness of a single, severable provision.

In *Theis Research, Inc. v. Brown & Bain*, where B&B's attempted formation of a legal services agreement with Theis was unlawful *per se*, the illegality applies to the purported contract as a whole. In such circumstances, the California courts have held that the entire agreement—including any arbitration clause—is void *ab initio*.[3] Because there was never any valid underlying agreement, there is no effective arbitration clause, and no authority is contractually conferred on an arbitrator. Without authority, any determination by an arbitrator is a nullity, and any arbitration award must be vacated.

[3] California authorities refer interchangeably to illegality and unlawfulness.

On the other hand, the California courts have held that illegality of a single provision, if severable, does not void a remaining lawful agreement. In that instance, the arbitration clause survives with the remainder of the contract; the parties' dispute is arbitrable; and even the illegality challenge to the single provision must be presented to the arbitrator—at least in the first instance.

Theis also addresses the role of courts in ruling on questions of illegality on post-arbitration review. The instant case comes before the Court pre-arbitration. The trial court denied petitioner's motion to compel arbitration and to stay judicial proceedings. Nevertheless, as discussed below, petitioner noted in its brief to the Florida Supreme Court the role of courts in addressing illegality in proceedings to enforce an arbitrator's award.

Theis has argued in support of its petition for a writ of certiorari that plenary review of *Theis Research, Inc. v. Brown & Bain* should be joined with consideration of this case to frame the complete picture of the matter at issue. Pending the Court's consideration of that request, Theis respectfully offers the arguments set forth below.

STATUTES INVOLVED

9 U.S.C. § 2. *Validity, irrevocability, and enforcement of agreements to arbitrate*

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3. *Stay of proceedings where issue therein referable to arbitration*

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4. *Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination*

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement . . . be in issue, the court shall proceed summarily to the trial thereof. . . . Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, . . . demand a jury trial of such issue, ...

9 U.S.C. § 9. *Award of arbitrators; confirmation; jurisdiction; procedure*

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, . . . any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. . . .

9 U.S.C. § 10. *Same; vacation; grounds; rehearing*

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) where the award was procured by corruption, fraud, or undue means;

* * *

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

* * *

SUMMARY OF ARGUMENT

Under the Federal Arbitration Act (FAA), the authority of an arbitrator pursuant to an arbitration clause embedded in a contract is premised on the validity of the underlying contract under state law applicable to contracts generally. There is no basis for submitting a matter to an arbitrator if illegality rendered the underlying contract void *ab initio*.

Accordingly, whether the underlying agreement is valid or void *ab initio* is a gateway issue that must be decided by a court. The fraud-in-the-inducement rule of *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), does not require a different result. That rule

presupposes the existence of a valid agreement, subject only to voidability and subsequent rescission at the option of a defrauded party.

While a court must determine a challenge based on unlawfulness that pertains to the underlying agreement as a whole, an illegality challenge could be submitted to an arbitrator in the first instance if it only concerns a single, severable provision and would not have the effect of voiding the remainder of the underlying contract (which includes the surviving arbitration clause).

Particularly on post-arbitration review, courts must decide illegality challenges if the FAA is not to be transmuted into a tool for the judicial enforcement of private contracts entered into in violation of generally applicable state law.

ARGUMENT

I. An underlying contract valid under state law is a precondition for an embedded arbitration clause to be effective under the Federal Arbitration Act

It takes a valid contract to have a valid contract with an arbitration clause.

The Federal Arbitration Act (FAA) conditions the effectiveness of an arbitration clause on compliance with law applicable to contracts generally. At 9 U.S.C. § 2, the FAA provides that an arbitration clause

> shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

State-law contract rules govern the validity of arbitration agreements. Although Congress enacted the FAA pre-*Erie*, the Court has effectuated principles of federalism in the application of § 2.

> When deciding whether the parties agreed to arbitrate a certain matter . . ., courts generally . . . should apply ordinary state-law principles that govern the formation of contracts.

First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995).

In *Prima Paint*, the Court noted that when enacting the FAA, Congress intended "to make arbitration agreements as enforceable as other contracts, but not more so." 388 U.S. at 404 n.12.

Interpreting § 2, the Court has applied this neutrality test in determining whether state law renders a purported arbitration clause invalid.

> States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added).

Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995); *accord Doctor's Associates v. Casarotto*, 517 U.S. 681, 686-687 (1996).

Under the FAA, the application by courts of "ordinary state-law principles that govern the formation of contracts"

pertains to the validity of contracts containing embedded arbitration clauses.

With respect to "a contract evidencing a transaction involving commerce," the power of an arbitrator depends upon "[a] written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . ., or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, ..." 9 U.S.C. § 2. Thus, § 2 speaks of both (a) an arbitration clause embedded in "a contract" and (b) an agreement created to arbitrate an existing controversy arising out of "a contract."

With respect to an embedded arbitration clause, § 2 necessarily requires "a contract" and that the contract be valid under law applicable to "any contract."

The first three times the term "contract" appears in § 2, it refers to an underlying agreement. There is no suggestion that when the term appears for the fourth time—conditioning validity on compliance with law applicable to "any contract"—such compliance with law is not required for the underlying agreement.

To premise an agreement to arbitrate on an arbitration clause embedded in an underlying contract, there must be an underlying agreement. Thus, the existence of a valid embedded arbitration clause depends on the existence of a valid underlying contract. A court cannot find an embedded arbitration clause effective under the FAA without finding the existence of an underlying contract valid under law applicable to "any contract."[4]

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[4] Indeed, it would have made no sense for Congress to have singled out underlying contracts, of all things, to have their

The language in the general provisions of the FAA (Chapter 1) indicates that the sections are to be read and understood in sequence. The sections that follow § 2 do not repeat the language of both (a) an arbitration clause embedded in "a contract" and (b) an agreement created to arbitrate an existing controversy arising out of "a contract."

Nevertheless, *both* of these are included when, for example:

- § 3 refers to "an agreement in writing for such arbitration" in the course of providing for a stay of judicial proceedings;

- § 4 refers to "a written agreement for arbitration" in prescribing means to compel arbitration;

- § 4 prescribes the judicial proceeding to adjudicate "the making of the arbitration agreement";

- § 9 refers to the parties' "agreement" in the course of providing for confirmation of an award (which section is in turn subject to the vacatur and modification provisions in §§ 10-11).

Thus, the "agreement . . . for . . . arbitration" and "the making of the arbitration agreement" referenced in §§ 3-4 necessarily contemplate, with respect to an embedded arbitration clause, an underlying contract made in compliance with state law and valid under law applicable to "any contract."

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validity determined without reference to law applicable to "any contract."

If illegality under state law applicable to "any contract" renders a purported underlying contract null and void *ab initio*, there is no valid contract into which to embed an arbitration clause. Therefore, no such purported arbitration clause can be given effect under the FAA.

A contrary determination would invite cataclysmic results. It would invite violation of general state law by effectuating arbitration clauses embedded in purported contracts entered into illegally. Further, it would trigger a mechanism for judicially enforced submission to arbitrations and awards premised on unlawful contracts.

II. Courts, as opposed to arbitrators, should decide a challenge to an underlying agreement as null and void *ab initio* for illegality

In the absence of an agreement by the parties, there is no basis to confer authority on an arbitrator. Instead, the authority of an arbitrator pursuant to an embedded arbitration clause is conditioned on the existence of an underlying agreement valid under state law applicable to contracts generally. The existence of a lawful agreement is a gateway issue that must be decided by a court.

If an arbitrator rejects a challenge to an underlying agreement as void *ab initio* for illegality, there is no basis to defer to the arbitrator's decision. A court must still decide the issue, and if it determines the contract void *ab initio* for illegality, the court must vacate the arbitrator's decision as *ultra vires*.

On the other hand, an arbitrator's decision that an underlying agreement is indeed void *ab initio* for illegality simply presents a conundrum. The decision finds that the arbitrator lacked authority to make the decision.

Congress did not assign to arbitrators the responsibility to decide whether an underlying agreement (with an embedded arbitration clause) even exists in the first place. Indeed, under § 4 of the FAA, upon demand a jury shall decide disputed issues of fact concerning whether the parties made an agreement to arbitrate.

Illegality, in particular, is a proper subject for determination by courts. For a court to place its imprimatur on illegality by confirming an arbitration award arising from an unlawful contract is anathema. More fundamentally, because government sets the laws that limit the power of private parties to contract, whether a purported contract is unlawful must ultimately be determined by someone commissioned by the government to decide questions of legality—a judge.

In *First Options*, 514 U.S. at 944-945, this Court held regarding arbitrability that courts, rather than arbitrators, decide the scope of an arbitrator's authority under an arbitration clause—unless the parties have explicitly agreed to confer power on the arbitrator to decide arbitrability. Yet even the power of an arbitrator to decide the scope of a clause, when so empowered by such an explicit agreement, presupposes the existence of a valid underlying contract or agreement.

In *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), this Court considered whether a court or an arbitrator should decide the availability of a class action under an arbitration clause. The Court did not consider the question foreclosed because arbitration awards had already been rendered. The plurality opinion found that such an issue should be remanded to the arbitrator, but it raised a distinction that should be applied in this case:

> In certain limited circumstances, courts assume that the parties intended courts, not arbitrators, to decide a particular arbitration-related matter . . . . They include certain gateway matters, such as whether the parties have a valid arbitration agreement at all . . ..

Id. at 452 (Breyer, J., joined by Scalia, J., Souter, J., Ginsburg, J.). Even as to the issue in *Green Tree*, the dissent of the Chief Justice (joined by O'Connor, J., Kennedy, J.) asserted that "this determination is one for the courts, not for the arbitrator, ..." *Id.* at 455.

A number of courts have distinguished between underlying contracts that are void *ab initio*—and therefore cannot confer any authority on an arbitrator—and underlying contracts that exist but are subject to voidability—permitting arbitrators to decide the matter in the first instance.

Applying the FAA, the California Supreme Court determined in *Rosenthal v. Great Western Financial Securities Corp.*, 14 Cal. 4th 394 (1996), that: "If the entire contract is void *ab initio* . . ., the parties have not agreed to arbitrate any controversy; . . .." *Id.* at 416.

In the case before it, the court distinguished between fraud in the execution of the underlying agreement and fraud in the inducement. Because fraud in the execution would render the contract void, it is to be determined by a court. *Id.* at 417. Fraud in the inducement, however, would not negate the existence of the contract, but would only render it voidable, permitting the defrauded party the election of rescinding or enforcing the contract. *Id.* at 415.

Accordingly, the California Supreme Court distinguished the rule set forth by this Court in *Prima*

Paint, that an arbitrator decides a defense of fraud in the inducement of a contract unless the fraud relates specifically to the arbitration clause itself and not to the contract generally. *Id.* at 416.

Several circuits have also held that courts—rather than arbitrators—are to decide issues as to whether an underlying contract even existed, or was null and void *ab initio*.

In *Three Valleys Mun. Water Dist. v. E.F. Hutton*, 925 F.2d 1136, 1140 (9th Cir. 1991), the Ninth Circuit previously held that courts, not arbitrators, decide issues that determine whether an underlying contract (with an arbitration clause) existed in the first place. *Id.* at 1140-1141. *Three Valleys* distinguished the rule in *Prima Paint*, explaining that *Prima Paint* only concerned an issue of "voidability"—not a challenge to whether a valid contract existed at the outset.

> . . . *Prima Paint* applies to "voidable" contracts—those "where one party was an infant, or where the contract was induced by fraud, mistake, or duress, or where breach of a warranty or other promise justifies the aggrieved party in putting an end to the contract." [Citation.] . . . . But, because an "arbitrator's jurisdiction is rooted in the agreement of the parties," [citations] a party who contests the making of a contract containing an arbitration provision cannot be compelled to arbitrate the threshold issue of the *existence* of an agreement to arbitrate. *Only a court can make that decision.*

925 F.2d at 1140-1141 (footnote omitted)(second emphasis added).

Other circuits have taken the *Three Valleys* approach. In *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99 (3d Cir. 2000), the Third Circuit held:

> Mindful of the doctrine announced in *Prima Paint*, which did not consider a situation in which the existence of the underlying contract was at issue, we draw a distinction between contracts that are asserted to be "void" or non-existent, as is contended here, and those that are merely "voidable," as was the contract at issue in *Prima Paint*, for purposes of evaluating whether the making of an arbitration agreement is in dispute.

Id. at 107 (footnote omitted). Whether there is an agreement to arbitrate in turn depends on the validity of the underlying contract. *Id.* at 106.

Citing *Three Valleys* and *Sandvik*, in *Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 31 (2d Cir. 2001), the Second Circuit also invoked "the distinction between void and voidable contracts, a distinction already recognized in at least two other circuits."

> A void contract is one that produces no legal obligation. . . . [A] party alleging that a contract is void—and providing some evidence in support—is entitled to a trial on the contract's arbitrability.

Id. at 31.[5]

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[5] Applying the FAA, the Supreme Court of Minnesota cited *Sphere Drake*, *Sandvik AB*, and *Three Valleys* in making the distinction that courts hear claims that a disputed contract is

In *Spahr v. Secco*, 330 F.3d 1266, 1272 n.7 (10th Cir. 2003), the Tenth Circuit acknowledged that:

> It is true that many circuits have applied *Prima Paint* to voidable contracts—i.e., those where the contract was induced by fraud, mistake, or duress—but not to void contracts.

The court proceeded to distinguish *Prima Paint* further, holding that even a question of voidability should be determined by the court—rather than the arbitrator—where the party objecting to arbitration asserted that the underlying agreement with the arbitration clause was unenforceable based on a lack of mental capacity to enter into the agreement in the first place. *Id.* at 1272-1273.

In *I.S. Joseph Co. v. Michigan Sugar Co.*, 803 F.2d 396 (8th Cir. 1986), the Eighth Circuit stated:

> Case law supports our holding that the enforceability of an arbitration clause is a question for the court when one party denies the existence of a contract with the other.

Id. at 400 (directing district court to disregard arbitrators' validity holding).

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void, while claims that a contract is *voidable* must be arbitrated. *Onvoy, Inc. v. SHAL, LLC*, 669 N.W.2d 344, 353 (Minn. 2003).

> [P]arties may not be compelled to arbitrate claims if they have alleged that the contract at issue never legally existed.

Id. at 354.

In *Microchip Tech. Inc. v. U.S. Philips Corp.*, 367 F.3d 1350, 1356-1358 (Fed. Cir. 2004), the Federal Circuit determined that whether the plaintiff was a successor to a license agreement, which contained an arbitration clause, was a "gateway" issue to be determined by a court. To determine whether an arbitration agreement exists, the existence of the entire agreement was a "threshold question" for the court. *Id.* at 1358.

Still other circuits, however, have taken a contrary approach, rejecting the "void" versus "voidable" distinction. *Will-Drill Res., Inc. v. Samson Res. Co.*, 352 F.3d 211, 215 n.15 (5th Cir. 2003). *Will-Drill* held that a court must determine whether a contract contained sufficient signatures to be valid and therefore binding on even admitted signatories. Attempting to distinguish Fifth Circuit precedent that an arbitrator determines whether illegality renders a contract void *ab initio*, the court conceded that:

> We are forced here to an admittedly fine distinction. And we do not doubt that this distinction will occasionally be elusive.

Id. at 219.

In *Burden v. Check into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001), the Sixth Circuit reversed and remanded a district court decision that relied on *Three Valleys* in holding that the court must determine whether illegality rendered an underlying agreement void *ab initio*. Citing *Burden*, the Eleventh Circuit in *Bess v. Check Express*, 294 F.3d 1298, 1306 (11th Cir. 2002), held that an arbitrator should determine whether illegality rendered the substance of the underlying agreement void.

Burden was subsequently criticized in its circuit in a concurring opinion in *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Kean-Argovitz Resorts*, 383 F.3d 512, 518-521 (6th Cir. 2004)(Cleland, D.J., sitting by designation, concurring):

> Void and void *ab initio* agreements, as opposed to voidable agreements, are agreements that never existed. Confining void (or void *ab initio*) contracts to a narrow set of circumstances, as the court did in *Burden*, abrogates long-standing principles defining void contracts and holds as of no effect any legislature's decision to deem certain agreements void when they fail to comply with statutory requirements, ...
>
> The Federal Arbitration Act's policy favoring arbitration cannot compel an agreement to arbitrate where no contract exists. *A void contract is simply nonexistent and a provision of a contract that does not exist should not be separately enforceable.* This includes an arbitration clause.

Id. at 520-521 (emphasis added).

Whether an underlying contract (with an embedded arbitration clause) is unlawful and therefore void *ab initio* is an issue that must be decided by a court.

III. Prima Paint does not require a different result

As referenced above, this Court set forth in *Prima Paint* a rule that an arbitrator decides a defense of fraud in the inducement of a contract unless the fraud relates specifically to the arbitration clause itself and not to the contract generally. 388 U.S. at 402-404.

The effect of such a claim is structurally different from the result of a challenge to an underlying contract as void *ab initio* for illegality. As explained by decisions discussed above, a claim of fraud in the inducement does not challenge the existence of an underlying contract as void *ab initio*, but rather it seeks to hold an extant contract voidable at the option of the defrauded party.

The *Prima Paint* rule serves the practical purpose of having closed a potential loophole that could have let a party avoid arbitration of a contractual dispute despite having entered into a valid agreement with an arbitration clause. If not for the rule, a party claiming breach of a contract (that contains an arbitration clause) could claim fraud in the inducement and avoid arbitration by simply alleging that the breach manifests a false promise without an intent to perform.

Indeed, this was the circumstance in *Prima Paint*. Prima Paint Corp. alleged that Flood & Conklin Mfg. Co. (F&C) breached a consulting agreement. 388 U.S. at 398. Prima Paint sought to avoid arbitration, alleging that F&C had fraudulently represented that it was solvent and would be able to perform its contractual obligations. *Id.* F&C did indeed enter into a bankruptcy reorganization proceeding one week after the parties had entered into the contract, but it emerged six months later. *Id.* at 398-399. Prima Paint waited nearly a year to claim fraud—when its first payment under the contract came due. *Id.* The alleged false promise

of an ability to perform the contract was intertwined with interpreting the particulars of the contract and assessing the parties' performance—issues properly subject to arbitration under the parties' valid, though arguably voidable, agreement.

The Court cited the Second Circuit's view expressed in the same case that, except where the parties otherwise intend, "arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are embedded, ..." *Id.* at 402. The Court noted the contrasting view of the First Circuit that "the question of 'severability' is one of state law, ..." *Id.* at 402-403.

However, in its own analysis of §§ 3-4, the Court made no further reference to "separable" or "severability." The Court distinguished between fraud-in-the-inducement claims directed to the contract generally from those directed to the arbitration clause in particular. *Id.* at 403-404. The Court stated that in deciding a stay application under § 3, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate. *Id.* at 404.

In *Prima Paint*, the Court did not consider whether an underlying contract with an embedded arbitration clause existed in the first place or was void *ab initio*. As discussed above, when such an issue is raised, to decide the existence of a valid embedded arbitration clause requires consideration of whether the underlying contract was created in compliance with state law applicable to "any contract" as required by § 2.

Dissenting in *Prima Paint*, Justice Black (joined by Douglas, J., Stewart, J.) expressed concern about the legal validity of contracts being adjudicated by arbitrators

"wholly unqualified to decide legal issues, and even if qualified to apply the law, not bound to do so." *Id.* at 407.

> [B]oth Congress and the framers of the Act were at great pains to emphasize that nonlawyers designated to adjust and arbitrate factual controversies arising out of valid contracts would not trespass upon the courts' prerogative to decide the legal question of whether any legal contract exists upon which to base an arbitration.

Id. at 408.

The fraud-in-the-inducement rule set forth in *Prima Paint* did not, as Justice Black may have feared, ride the FAA off a cliff. The dissent, however, provides a glimpse of the precipice should the holding be unreasonably extended to require arbitration in the absence of a legally valid underlying contract as determined by the courts.

Several members of the Court have at times expressed concern that the FAA should not be given an improper reach simply by extension from one case to the next. Concurring in *Allied-Bruce Terminix Cos. v. Dobson*, Justice O'Connor stated that:

> We have often said that the pre-emptive effect of a federal statute is fundamentally a question of congressional intent. [Citations.] Indeed, we have held that "'where . . . the field which Congress is said to have pre-empted' includes areas that have 'been traditionally occupied by the States,' congressional intent to supersede state laws must be 'clear and manifest.'" [Citation.] Yet, over the past decade, the Court has

> abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation.

513 U.S. at 283. *See also id.* at 284-285 (Scalia, J. dissenting), 285-297 (Thomas, J., dissenting).

Discussing the scope of the FAA, the dissent of Justice Stevens in *Circuit City Stores v. Adams*, 532 U.S. 105 (2001), observed that:

> Times have changed. Judges in the 19th century disfavored private arbitration. The 1925 Act was intended to overcome that attitude, but a number of this Court's cases decided in the last several decades have pushed the pendulum far beyond a neutral attitude and endorsed a policy that strongly favors private arbitration. . . . There is little doubt that the Court's interpretation of the Act has given it a scope far beyond the expectations of the Congress that enacted it.

Id., at 131-132 (footnotes and citations omitted)(joined by Souter, J., Ginsburg, J., Breyer, J.).

If the FAA is now construed as a general federal license—and enforcement mechanism—for private parties to contract in violation of state law, the pendulum will have broken loose. Unhinged from law, the pendulum will become a hammer that wrecks havoc. Congress certainly never intended the FAA to be a mechanism for parties to circumvent by private agreement the effective exercise of general police powers by the states.

IV. Whether a matter is first referred to arbitration may turn on whether the challenge for unlawfulness is limited to a single, severable provision

There is a logical distinction between an illegality challenge directed to the underlying contract as a whole and one directed to a single, severable provision.

If the illegality voids the entire contract, there is no surviving arbitration clause—and no power could have been conferred on an arbitrator.

Conversely, illegality of a single provision, if severable from an otherwise valid contract that contains the arbitration clause, does not void the remaining lawful agreement. In that circumstance, the arbitration clause survives with the remainder of the contract; the parties' dispute is arbitrable; and even the illegality challenge to the single provision may be presented to the arbitrator—at least in the first instance.

Potentially, if the unlawfulness turns on the interpretation of a single provision of the contract, the arbitrator might construe that provision so as to avoid a conflict with state law.

The California courts have long applied this distinction. Determining that the illegality concerned the formation of the purported underlying contract, the California Supreme Court in *Loving & Evans v. Blick*, 33 Cal. 2d 603, 609-612 (1949), vacated a resulting arbitration award. Citing a state statute (Cal. Code Civ. Proc. § 1288(d)) that tracks the language of the FAA, 9 U.S.C. § 10(a)(4), the court held that:

> [T]he award must be vacated "where the arbitrators exceeded their powers, . . ." It

> seems clear that the power of the arbitrator to determine the rights of the parties is dependent upon the existence of a valid contract under which such rights might arise.

Id. at 609-610.

In *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992), the California Supreme Court distinguished an unlawfulness challenge directed to a single, severable provision from a challenge to an underlying agreement as a whole:

> Both *Loving & Evans*, *supra*, 33 Cal. 2d 603, and *All Points Traders* [*v. Barrington Associates*], 211 Cal. App. 3d 723 [(1989)], permitted judicial review of an arbitrator's ruling where a party claimed the entire contract or transaction was illegal. By contrast, Moncharsh challenges but a single provision of the overall employment contract.

3 Cal. 4th at 32. The court determined that the arbitration clause survived in an otherwise valid employment contract and that enforceability of the single provision should have been submitted to the arbitrator.

If this Court determines that such a distinction is the correct approach under the FAA, it still might affirm. The Court might determine as a matter of federal law that the contractual provision challenged as usurious is so material that it affects the contract as a whole, or it might determine that the severability of a single unlawful provision should be determined according to state contract law. In this case, where the Florida Supreme Court asserted with respect to the arbitration clause that "there are no severable, or

salvageable, parts of a contract found illegal and void under Florida law" (894 So. 2d at 864), the result would then turn on this being a rule of general application, such that illegality of a single provision voids the entire contract.

V. Courts must decide illegality challenges, especially on post-arbitration review

Even if a party must first go to arbitration, a party is entitled to have its illegality challenge to a contract with an embedded arbitration clause decided finally—at some point—by a court rather than an arbitrator. *Cf. generally* Akhil Reed Amar, *A Neo-Federalist View of Article III: Separating the Two Tiers of Federal Jurisdiction*, 65 B.U. L. Rev. 205, 233-234, 246-255 (1985)(for two categories of cases in the first tier of Article III jurisdiction—"all" federal question cases and "all" admiralty cases—although the Constitution does not mandate *original* jurisdiction in the federal courts, a party must have a real opportunity to have the case resolved in a federal court at some point).

Such a guarantee is a necessary assurance against the misuse of arbitration to perpetrate unlawful conduct.

Petitioner Buckeye Check Cashing recognized as much in the answering brief it filed with the Florida Supreme Court. Petitioner cited the Ninth Circuit's first decision in *Theis Research, Inc. v. Brown & Bain*, arguing that:

> The simple answer to [respondents Cardegna and Reuter's] imaginative hypothetical concerning a contract to purchase and sell drugs that contained an arbitration provision, [br. citation], is that assuming there is no specific attack on the making of the arbitration agreement, the dispute would be directed to arbitration.

> Presumably, no arbitrator would enforce the underlying contract, but even if he or she did, a court would not enforce the arbitrator's award. *See, e.g., Theis Research, Inc. v. Brown & Bain*, 240 F.3d 795, 796 (9th Cir. 2001) ("TRI's assertions that the arbitration award was invalid because it was based on an illegal contract are properly resolved in the context of TRI's motion to vacate the award.").

Answer Br. at 17 n.2.

In its current decision, however, the Ninth Circuit has reversed course, holding (erroneously) that presenting the illegality challenge to an arbitrator bars courts from thereafter deciding the issue.

> Theis submitted to the arbitrator the issue whether B&B's alleged conflicts of interest rendered the Theis-B&B legal services agreement void *ab initio*. The arbitrator rendered a decision on this issue adverse to Theis. The district court thus did not err when it determined that Theis was barred from relitigating the same issue as part of its federal court malpractice claims.

Theis Research, Inc. v. Brown & Bain, 400 F.3d 659, 666 (9th Cir. 2005). The Ninth Circuit's holding must be disapproved and overruled.

California decisions have underscored the importance of judicial determination of an illegality challenge, particularly when raised in a proceeding to review an arbitration award. In *Loving & Evans*, the California Supreme Court explained that:

> [T]he rules which give finality to the arbitrator's determination of ordinary questions of fact or of law are inapplicable where the issue of illegality of the entire transaction is raised in a proceeding for the enforcement of the arbitrator's award.

33 Cal. 2d at 609. It made no difference that both sides had jointly submitted their dispute to arbitration "in line with" the underlying agreement. *Id.* at 604.[6]

The alternative to judicial determination is that courts would become the silent partners of those who would misuse arbitration to perpetrate unlawful conduct through illegal contracts. The FAA requires no such result. Instead, it prohibits such misuse by requiring in § 10 that courts vacate *ultra vires* awards—"where the arbitrators exceeded their powers . . .."

---

[6] Even if, *arguendo*, despite the absence of authority in the FAA, arbitrators were granted limited authority to decide the existence of an agreement on which to base their own jurisdiction by (inapposite) analogy to the limited jurisdiction of federal courts to decide their own subject matter jurisdiction, judicial review of such decisions should then be *de novo*, *sua sponte*, and unwaivable.

CONCLUSION

Theis respectfully requests that the Court determine under the Federal Arbitration Act that if, under state law, a contract is unlawful as a whole and therefore void *ab initio*, then an arbitration clause embedded in such purported contract is without effect and confers no power on an arbitrator; that any arbitration award arising from such purported contract and clause is a nullity and must be vacated; and that courts—as opposed to arbitrators—shall decide such assertions of unlawfulness, regardless of the stage of proceedings.

Respectfully,

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August 2005

(15)

No. 04-1264

Supreme Court, U.S.
FILED
SEP 23 2005
OFFICE OF THE CLERK

In The

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA and DONNA REUTER,

Respondents.

On Writ Of Certiorari To The Supreme Court Of Florida

BRIEF OF UNIVERSITY OF WISCONSIN LAW PROFESSORS AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICI CURIAE

Amici curiae are law professors whose teaching and scholarship focus on federalism, and in particular, the preservation of the states' role as "laboratories of experimentation in social policy." *United States v. Lopez*, 514 U.S. 549, 581 (1995) (Kennedy, J., concurring) (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)).[1] Amici have studied the doctrine of Federal Arbitration Act preemption and note with great concern that it is one of the most sweeping doctrines of federal preemption in current American law, one that has made great inroads into state autonomy and policy experimentation in areas traditionally left to state law. Moreover, amici are concerned that *Southland Corp. v. Keating*, 465 U.S. 1 (1984), which establishes FAA preemption, was wrongly decided as a matter of statutory interpretation and in fact applies the FAA unconstitutionally as a Congressional assertion of control over state court structure, procedure and jurisdiction.

SUMMARY OF ARGUMENT

The question before the Court, whether the rule of *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), must be applied by a state court, presents at bottom a question of Federal Arbitration Act preemption

[1] Letters of consent to the filing of amicus briefs, including this one, have been lodged with the Clerk of the Court pursuant to Rule 37.3. Pursuant to Rule 37.6, counsel for amici state that no counsel for a party authored this brief in whole or in part, and no person other than amici or their counsel have made a monetary contribution to the preparation or submission of this brief.

that depends on the validity of *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

Although the Justices of this Court have divided closely on certain issues relating to federalism and Congressional power to control state policymaking, *see, e.g., United States v. Morrison*, 529 U.S. 598 (2000), *Printz v. United States*, 521 U.S. 897 (1997), this Court has been unanimous in reaffirming the centuries-old principle that states retain sovereignty over the structure, procedure and jurisdiction of their courts. *See Johnson v. Fankell*, 520 U.S. 911 (1997); *Howlett v. Rose*, 496 U.S. 356, 372 (1990).

FAA preemption flies in the face of this principle of respect for state court procedural autonomy. Notwithstanding *Southland*'s conclusory assertion that the FAA is substantive, the FAA and its rule of enforcement of arbitration agreements is fundamentally procedural: it imposes a choice of the forum that will hear the case and an accompanying procedural regime. Thus, as applied to cases such as this one – a state law matter heard in state court – the FAA heedlessly restructures state court procedures and runs roughshod over the state's choices on the allocation of authority to various tribunals within its own dispute resolution system.

Although this Court has never had occasion to address the question head on, the structure of the Constitution and this Court's longstanding precedents weigh heavily against the idea that Congress has the authority to impose procedural rules on state courts. *See* David S. Schwartz, *The Federal Arbitration Act and the Power of Congress Over State Courts*, 83 Oregon L. Rev. 541 (2004). But even if this Court chooses not to reach that question in this case, it is still clear that *Southland* erred. Given the FAA's

fundamentally procedural character, *Southland* violated well-established doctrines of statutory interpretation – the doctrine of constitutional avoidance and the presumption against preemption – in holding that the FAA binds state courts. Because the argument of Petitioner Buckeye Check Cashing depends on an application of *Southland* to apply the *Prima Paint* rule to state courts, the court below can be reversed only if *Southland* is reaffirmed. Amici urge this Court to take this opportunity to overrule *Southland*.

ARGUMENT

I. FAA PREEMPTION IS UNCONSTITUTIONAL

A. Despite *Southland*'s Assertion to the Contrary, the FAA is Procedural Regulation that Cannot Constitutionally Control State Courts

While the Supremacy Clause obligates state courts to apply federal *substantive* law applicable in cases before them, it is well established that state courts at all times retain control over their own procedures. (*See infra* section B.) This Court has recently observed that "the meaning of 'substance' and 'procedure' in a particular context is 'largely determined by the purposes for which the dichotomy is drawn.'" *Jinks v. Richland County*, 538 U.S. 456, 465 (2003) (quoting *Sun Oil Co. v. Wortman*, 486 U.S. 717, 726 (1988)). *Southland* decided this question without reference to such purposes, and its conclusion that the FAA is substantive law does not withstand scrutiny. From any angle, the FAA is fundamentally procedural.

1. The Enforcement of Arbitration Agreements is Fundamentally Procedural

Substantive law controls "the primary activity of citizens." *Hanna v. Plumer*, 380 U.S. 460, 474 (1965) (Harlan, J., concurring), and is equated with "rights of recovery." *Felder v. Casey*, 487 U.S. 131, 141, 150 (1988). Procedural rules, in contrast, do not affect primary activity, but simply define how and by whom a dispute will be heard. Thus, this Court has held that changes in procedural rules "instituted after the conduct giving rise to the suit" will be applied without concerns regarding retroactivity "[b]ecause rules of procedure regulate secondary rather than primary conduct[.]" *Landgraf v. USI Film Prods.*, 511 U.S. 244, 275 (1994). Likewise, new jurisdictional rules will normally be applied to pending cases because they "speak to the power of the court rather than to the rights or obligations of the parties" and "take away no substantive right but simply change[] the tribunal that is to hear the case." *Id.* at 274 (internal citations and quotations omitted).

Although the FAA provides for an apparent "right of action" to enforce a contract, an arbitration agreement is simply a contract about procedure. It does not establish any primary rights or duties, or create a right of recovery, but rather establishes the rules to be followed in the event of a dispute. An arbitration agreement affects only "the allocation of power between alternative tribunals." *See Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 60 (1995). Once the court enforces the arbitration agreement, the consequences are entirely procedural. Enforcement of an arbitration agreement is the imposition of "alternative dispute resolution," which simply "trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of

arbitration." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 630 (1985). An arbitration agreement is no more "substantive" than a pre-dispute contract agreeing on the number of depositions to be taken in a future lawsuit. In retroactivity terms, whether or not an arbitration agreement is enforced is not substantive because it "simply changes the tribunal that is to hear the case." *Landgraf*, 511 U.S. at 274; *see Mastrobuono*, 514 U.S. at 60. Overruling *Southland* and dispensing with FAA preemption would not disturb the kind of reliance interests considered in retroactivity cases: "Primary behavior is not affected: No rule of conduct is retroactively changed, but only (perhaps) the forum in which violation is to be determined and remedied." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 285 (1995) (Scalia, J., dissenting).

2. This Court Has Held Arbitration to be Procedural in the Context of Pre-Dispute Waivers

It is well established that substantive rights and remedies are not waivable in pre-dispute adhesion contracts. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985) ("[i]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy"); *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697, 727 (1945) (advance waiver of remedies for wage and hour violations void because it would "nullify the purposes of the statute); *see generally Restatement (Second) of Contracts* § 195(1) (1981); 6A *Corbin on Contracts* § 1515 (1962).

At one time this Court applied the same principle to arbitration agreements, on the theory that compelling arbitration as a substitute for judicial enforcement adversely affected substantive rights. In *Wilko v. Swan*, 346 U.S. 427 (1953), the Court rejected a claim by a defendant brokerage firm to enforce a predispute arbitration agreement against a customer asserting a claim under the Securities Act of 1933. The Court held that the right to enforce the Securities Act provisions in court was a nonwaivable "substantial" right pursuant to § 14 of the Act, which prohibited any contract term "purporting to . . . waive compliance with any provision of this law," 15 U.S.C. § 77n.

But in *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989), this Court overruled *Wilko*, holding that the right to a judicial forum for Securities Act claims, as against a predispute arbitration agreement, is not substantive. The antiwaiver language in the Securities Act should have been "read to relate to *substantive* provisions of the Act" *rather than* arbitration. 490 U.S. at 480 (internal quotations omitted) (emphasis added). This Court specifically rejected *Wilko*'s determination that arbitration affected substantive rights, calling the selection of an arbitral versus a judicial forum merely "procedural." *Id.* at 482. The Court's recent FAA cases repeatedly affirm that arbitration agreements are "in effect, a specialized kind of forum selection clause," *id.* at 482-83 (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 (1974); *accord EEOC v. Waffle House*, 534 U.S. 279, 295 (2002), and that a party compelled to arbitrate "does not forgo . . . substantive rights," but "only submits to their resolution in an arbitral, rather than a judicial, forum." *E.g.*, *Circuit City Stores v. Adams*, 532 U.S. 105, 123 (2001) ("by agreeing to

arbitrate ... a party does not forego ... substantive rights"); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (same); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 630 (1985) (same).[2]

3. This Court Has Held Arbitration to be Procedural in the Conflict of Laws Context

Conflict of laws principles may sometimes require a state court to apply the substantive law of another state, but a state court may always apply its own procedural law. *Restatement (Second) of Conflict of Laws* § 122. Thus, in *Sun Oil Co. v. Wortman*, 486 U.S. 717 (1987), this Court held that a state could apply its own statute of limitations to a cause of action governed by the substantive law of a sister state; the statute of limitations was procedural for

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[2] These holdings vitiate one of *Southland*'s primary rationales for imposing FAA § 2 on the states: the purported need to impose a uniform federal rule to prevent forum shopping. *Southland*, 465 U.S. at 15. Forum shopping is a concern only where the parties are able to shop for favorable *substantive* rules that are likely to affect the outcome. But because the enforcement *vel non* of the arbitration agreement should *not* affect the outcome of a case, there is no forum shopping problem – any more than with any forum selection clause, where the same substantive law would be applied by the alternate fora.

On similar grounds, it is also clear that arbitration would be deemed procedural for *Erie* purposes. Although this Court has had no occasion to revisit its determination in *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 (1956), that arbitration is "outcome determinative," the holding and rationale of *Rodriguez* effectively overrule *Bernhardt* on this point. *Erie* analysis is supposed to be guided by the "twin aims" of discouraging forum shopping and avoiding unfairness in the administration of justice, neither of which are an issue if arbitration provides a fair forum that creates no predictable advantage to one side. *See* Schwartz, *Power of Congress*, *supra*, 83 Ore. L. Rev. at 607-09.

choice-of-law purposes, and therefore a matter of state sovereignty. *Id.* at 726, 727.

In *Mastrobuono v. Sheason Lehman Hutton*, 514 U.S. 52 (1995), this Court was asked to determine whether a choice-of-law clause adopting "the laws of the state of New York" was intended to incorporate a state law rule barring arbitrators from awarding punitive damages. The Court held the agreement to be ambiguous on this point, in large part because choice of law provisions are naturally read to include only substantive law: "In other words, the provision might include only New York's substantive rights and obligations, and not the State's allocation of power between alternative tribunals." *Id.* at 60. By placing the question of the state's "allocation of power between" courts and arbitrators on the other side of the line from "substantive rights and obligations," *Mastrobuono* plainly holds that arbitration is not substantive law for conflict-of-laws purposes.

4. *Southland*'s Statement that the FAA is Substantive Law for Preemption Purposes is Erroneous

Southland's assertion that the FAA is substantive law is contradicted by the basic understanding of the distinction between substantive and procedural law, as well as by this Court's more recent decisions holding arbitration to be procedural for pre-dispute waiver and conflict-of-laws purposes. Can it be said that preemption and the Supremacy Clause are a different "context" for purposes of a substance/procedure line? Even if the answer to that question is "yes," *Southland* errs by holding arbitration and the FAA to be substantive for preemption purposes.

In the Supremacy context, "the purposes for which the [substance-procedure] dichotomy is drawn," *Jinks*, 538 U.S. at 465, must be to balance the federalism interest between Congress's power to govern the people of the several states under its enumerated powers and the states' interest in maintaining sovereignty over their courts. Analysis of the substance-procedure distinction for Supremacy purposes should consider whether the federal statute restructures or modifies neutral rules of state judicial administration without the presence of a substantive impact on primary rights. Looking at the state sovereignty stakes, the effect of the FAA as a procedural restructuring of state courts is readily apparent. With FAA preemption, state law cases between non-diverse parties – cases that would be decided entirely within the state court system, such as the instant case – must be reallocated to the alternative dispute resolution forum, notwithstanding any contrary state policy. One set of procedures – arbitration procedures – is thereby substituted for state-mandated procedures. Although most states have arbitration enforcement statutes, many of these create exceptions allowing certain categories of cases to remain in court. Thus, the FAA should be viewed as procedural for Supremacy Clause purposes because its primary effect, applied to the states, is to restructure state judicial systems by overriding state decisions about how to allocate disputes among alternative fora within the state dispute resolution system.

Two objections could be raised to the argument that arbitration of a would-be state court case is part of the state's dispute resolution system. First, it can be argued that the FAA federalizes all arbitration law. *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983) (dicta). Where the FAA applies, this argument

suggests, arbitration is an adjunct federal forum with exclusive jurisdiction, rather than an alternative state forum. In this light, the FAA's intrusion on state sovereignty is essentially the same as that of the National Labor Relations Board, a non-judicial federal instrumentality which has exclusive original jurisdiction over certain labor law matters, displacing state courts. *See San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236, 241-42 (1959) (holding that National Labor Relations Board has preemptive primary jurisdiction over federal labor matters); National Labor Relations Act § 10, 29 U.S.C. § 160 (2000) (same).

But this argument fails. While arbitration may be a federal adjunct in those cases where arbitration is compelled by a federal court, FAA preemption means that state courts must compel arbitration, even where no federal jurisdiction is present. Moreover, exclusive federal jurisdiction results from an assertion of federal subject matter jurisdiction, which the FAA does not create. *See Southland*, 465 U.S. at 15 n.9. A law cannot deprive state courts of jurisdiction while at the same time expecting state courts to apply it.[3]

The second objection is that arbitration is "private": the FAA does not restructure state courts, it could be argued, but rather bars a class of cases from state court and sends them into a third world of adjudication, one that

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[3] Where federal courts have exclusive jurisdiction, a state court must simply dismiss the case – the state court's involvement ends. With arbitration, under the FAA and state analogues, a court normally stays the litigation but retains jurisdiction as the parties arbitrate. Often the winner in arbitration will return to court to ask for the award to be confirmed as a judgment; sometimes the loser will seek to have the award set aside on one of the limited grounds for judicial review.

is independent of both the state and federal systems. But this objection likewise fails. To begin with, the creation of a right of action – whether enforced in arbitration or court – means opening the door of the state's dispute resolution system. Moreover, most of the "law" of arbitration – and certainly the doctrine of FAA preemption – arises only in the context of disputed arbitration agreements. Where parties engage in truly private ordering to resolve their disputes, they can reach a private agreement to arbitrate (pre-dispute or not), adhere to that agreement without contesting it in court, and submit voluntarily to the arbitrator's decision. But the FAA and state arbitration statutes make that process part of the public dispute resolution system for any dispute where one of the parties deviates from that purely private model – typically, by resisting arbitration or asking a court to compel it; by seeking judicial review of a disputed procedural matter or of the arbitrator's award; or by seeking to confirm the arbitration award as a judgment of the court. Invoking any aspect of an arbitration statute crosses a significant line from pure private ordering into a zone of public dispute resolution. Even where the parties submit to a pre-dispute arbitration agreement without litigating any enforcement issues, the background law of enforcement – and the prospect of state coercion or enforcement – make that agreement part of the state system. Only if an arbitration were purely voluntary at every stage – regardless of background state arbitration law – could it be seriously contended that arbitration was not part of the state dispute resolution system.

B. Congress Lacks the Power to Regulate State Court Procedures

1. Constitutional Structure and Centuries of Precedent Dispel the Idea of a General Congressional Power to Regulate State Court Procedures

Questions of procedure "belong[] to the discretion of every government, consulting its own interest and convenience." 2 J. Kent, *Commentaries on American Law* 462-63 (2d ed. 1832). A state's authority over the structure and procedure of its own court system is a fundamental attribute of state sovereignty. "Through the structure of its government, and the character of those who exercise government authority, a State defines itself as a sovereign." *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1990). Procedural questions fundamentally concern the allocation of the state's decisionmaking power to courts. This allocation question – "deciding who decides" – is the most basic question of Constitution-making, and therefore goes to the very heart of government sovereignty. How procedural systems are structured also determines the nature of justice that is delivered. For these reasons, this Court has repeatedly treated as axiomatic the notion that states are sovereign over the structure, jurisdiction and procedure of their court systems. As this Court unanimously declared in *Johnson v. Fankell*, 520 U.S. 911 (1997), "We have made it quite clear that it is a matter for each state to decide how to structure its judicial system." *Id.* at 923 n.13. Over a century earlier, the Court likewise stated, "Undoubtedly, a state may regulate at pleasure the modes of proceeding in its courts." *Bronson v. Kinzie*, 42 U.S. (1 How.) 311, 315 (1842); *accord Howlett v. Rose*, 496 U.S. 356, 372 (1990) ("the states have great latitude to establish the structure

and jurisdiction of their own courts"); *Wolfe v. North Carolina*, 364 U.S. 177, 195 (1960) ("Without any doubt it rests with each State to prescribe the jurisdiction of its appellate courts, the mode and time of invoking that jurisdiction, and the rules of practice to be applied in its exercise"); *Hardware Dealers Mut. Fire Ins. Co. v. Glidden Co.*, 284 U.S. 151 (1931) ("the procedure by which rights may be enforced and wrongs remedied is particularly a subject of state regulation and control"); *Tarble's Case*, 80 U.S. (13 Wall.) 397, 407 (1871) ("How [state and federal governments'] respective laws shall be enacted; how they shall be carried into execution; *and in what tribunals*, or by what officers ... are matters subject to their own control, and in the regulation of which neither can interfere with the other") (emphasis added).

The Constitution nowhere grants Congress any general power to regulate the judiciaries of the several states. This absence is striking, in light of the framers' twin assumptions that state courts would play a central role in handling not only interstate judicial business arising under state law, but also (pending creation of lower federal courts) a significant quantity of federal judicial business. *See* The Federalist No. 82, at 492-95 (Hamilton) (Rossiter ed. 1961). Where the Constitution grants Congress general authority to regulate a court system, the Constitution speaks of a power to "constitute" or "ordain and establish" "Tribunals" or "Courts" that are "inferior" to the Supreme Court. U.S. Const. Art. I, § 8, cl. 9; U.S. Const. Art. III, § 1. These are plainly federal courts. According to Chief Justice Marshall, "state courts are not, in any sense of the word, inferior courts ... because they emanate from a different authority, and are the creatures of a distinct government." *Ex parte Bollman*, 8 U.S. (4 Cranch) 75, 97 (1807); *see,*

e.g., *Minneapolis & St. L. R. Co. v. Bombolis*, 241 U.S. 211, 222 (1916) (Supremacy Clause requirement that state courts hear federal cases "in no sense implied . . . that for the purpose of enforcing the right the state court was to be treated as a Federal Court deriving its authority not from the State creating it, but from the United States").[4]

2. The Supremacy Clause Imposes Only Federal Substantive Law, and Not Procedural Law, on the State Courts

The Supremacy Clause[5] obligates state judges to apply federal substantive law applicable to disputes in state court, *see Testa v. Katt*, 330 U.S. 386 (1947), but nothing in

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[4] The Full Faith and Credit Clause, U.S. Const. Art. IV, § 1, allows Congress limited authority to regulate procedural questions respecting the effect of the judgments of one state's court in another, as well as rules governing the choice of law in state courts. *See, e.g., Sun Oil Co. v. Wortman*, 486 U.S. 717, 729 (1987). However, this specific constitutional mandate involves coordination of states' authority vis à vis each other, rather than between the federal and state sovereignties, and is a far cry from a general power over state court procedures.

[5] The Supremacy Clause provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; *and the judges in every state shall be bound thereby*, any Thing in the constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. Art. VI, cl. 2 (emphasis added). It has never seriously been argued that the Supremacy Clause is itself an affirmative grant of legislative authority to Congress to control state courts; rather, any federal statute binding on state courts must be duly enacted according to one of Congress's enumerated powers. *See, e.g., Printz v. United States*, 521 U.S. 897, 925 (1997).

this obligation implies any diminution of state sovereignty over how those courts are constituted or what procedures they will follow. On the contrary, the framers recognized that the power of state courts to apply federal law follows from their pre-existing jurisdiction. Thus, Hamilton argued that state courts will necessarily have "a concurrent jurisdiction in all cases arising under the laws of the Union where it is not expressly prohibited," precisely because "[t]he judiciary power of every government" includes the power to apply the substantive law of any sovereign that may be applicable to a dispute before it. The Federalist No. 82, at 492 (Hamilton); *see Cohens v. Virginia*, 19 U.S. (6 Wheat) 264, 415 (1821) (per Marshall, C.J.) (Supreme Court review of federal law decisions in state court was needed precisely because federal questions were otherwise "confided . . . to the state courts, *however they may be constituted*") (emphasis added).

The modern Supreme Court has repeatedly reaffirmed "the general rule, 'bottomed deeply in belief in the importance of state control of state judicial procedure, . . . that federal law takes the state courts as it finds them.'" *Howlett v. Rose*, 496 U.S. 356, 372 (1990) (quoting Henry Hart, *The Relations Between State and Federal Law*, 54 Colum. L. Rev. 489, 508 (1954)); *accord Johnson v. Fankell*, 520 U.S. 911, 919 (1997). This Court has recognized that *Testa*'s "requirement that a state court of competent jurisdiction treat federal law as the law of the land does not necessarily include within it a requirement that the State create a court competent to hear the case in which the federal claim is presented." *Howlett*, 496 U.S. at 372. Indeed, *Testa* is a continuation of a long-standing line of cases which take pains to point out that in imposing federal *substantive* law on state courts via the Supremacy

Clause, Congress "had not attempted 'to enlarge or regulate the jurisdiction of state courts or to control or affect their modes of procedure[.]" *Howlett*, 496 U.S. at 373 (quoting *Mondou v. New York, N.H. & Hart. R. Co.*, 223 U.S. 1, 56 (1912)).

Even where a significant federal right may be lost due to neutral state procedural rules, this Court has reaffirmed the procedural autonomy of state courts. In *Johnson v. Fankell*, the Idaho courts had applied state appellate procedure to deny the defendant state officials an interlocutory appeal from the trial court's denial of summary judgment on their qualified immunity defense. Under federal law, in contrast, a district court order denying a qualified immunity defense prior to final judgment – whether on a 12(b)(6) motion to dismiss or motion for summary judgment – is immediately appealable on an interlocutory basis. *Mitchell v. Forsyth*, 472 U.S. 511 (1985). Thus, under *Mitchell*, a valid qualified immunity defense carries in tow the important procedural right not to have to submit to the burden of pretrial litigation, particularly discovery processes. The *Johnson* defendants argued that the right to interlocutory appeal was bound up with their substantive federal defense of qualified immunity, and that the Idaho rule barring interlocutory appeal was therefore preempted because it interfered with their federal right to be free from burdensome pretrial litigation – an interest very similar to that asserted by a party seeking to compel arbitration.

This Court unanimously rejected that argument. The Court reasoned that the "normal presumption against preemption" was "buttressed" by the compelling federalism interest in allowing states to control their own judicial procedures; the Idaho courts' dismissal of the interlocutory

appeal "rested squarely on a neutral state Rule regarding the administration of the state courts." 520 U.S. at 918. "Principles [that] are fundamental to a system of federalism" outweighed the defendant's argument that their federal rights would justify "requir[ing] a State to undertake something as fundamental as restructuring the operation of its courts." *Id.* at 922. Thus, as *Johnson v. Fankell* makes clear, federal supremacy of substantive law stops short of permitting Congress to override neutral rules of state procedure or judicial administration.[6]

3. The Commerce Power Does Not Authorize Procedural Regulation of State Courts

Assuming arguendo that state court litigation comes within one of the definitions of "interstate commerce" – which is open to debate, *see United States v. Morrison*, 529 U.S. 598 (2000); *United States v. Lopez*, 514 U.S. 549 (1995) – that does nothing to undermine this Court's longstanding recognition of the states' sovereignty over their own court procedures. In *Johnson v. Fankell*, there was no question that section 1983 claims were within Congress's enumerated powers; nevertheless, the Court held that Congress's power over substance did not extend to a power over state court procedure.

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[6] In a handful of cases, this Court has recognized a limited exception – the so-called "reverse-*Erie*" doctrine – in which Congress may influence some procedural incidents of federal rights heard in state courts by preempting non-neutral state procedures that unduly discriminate against substantive federal rights. *See Felder v. Casey*, 487 U.S. 131, 138 (1988) (striking down Wisconsin statute imposing special notice requirement on federal civil rights plaintiffs); *Dice v. Akron, Canton & Youngstown R. Co.*, 342 U.S. 359 (1952); *see* Schwartz, *Power of Congress*, *supra*, 83 Ore. L. Rev. at 581-88.

Moreover, this Court's holdings in *New York v. United States*, 505 U.S. 144 (1992) and *Printz v. United States*, 521 U.S. 897 (1997), should foreclose the notion that Congress can directly regulate state court structure, procedure and jurisdiction. The *Testa* line of cases is quite consistent with the principle underlying *Printz* and *New York*, that federal supremacy means the power of Congress to regulate the people directly, but not the power to regulate the people indirectly by regulating state governments. *See New York*, 505 U.S. at 164-65; *Printz*, 521 U.S. at 920. A Congressional directive to change a state court procedure is not simply a command to apply existing state judicial resources to enforce a federal right, but a directive to state courts to regulate litigants in a particular way. Codes of procedure either come directly from state legislatures, or else from courts in a quasi-legislative, rulemaking capacity, or from state constitutions. Likewise, the creation of a court and the definition of its jurisdiction are in the first instance legislative or constitutional acts, rather judicial acts. To assert control over procedure or jurisdiction, Congress would have to "commandeer" the state legislature or its constitutional process. Congressional control over state procedure thus seems to be the very sort of commandeering condemned in *Printz* and *New York*. Federalism principles, whether located in the Tenth Amendment or elsewhere, *see New York*, 505 U.S. at 156, 160; *Printz*, 521 U.S. at 518; *Reno v. Condon*, 528 U.S. 141, 147 (2000), protect the states' sovereignty over their governmental processes from such commandeering.[7]

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[7] Congress *does* have the power to displace state court jurisdiction entirely: by creating substantive federal rights, preempting state law and giving federal courts exclusive jurisdiction, as it has done under

(Continued on following page)

II. THIS CASE PRESENTS THE PROPER OCCASION TO OVERRULE *SOUTHLAND*

Although, strangely, Petitioner's brief cites *Southland* only once and never even mentions preemption, Petitioner's argument squarely depends on *Southland* and the doctrine of FAA preemption. Without *Southland*, there could be no conceivable basis for arguing that the *Prima Paint* rule – a federal rule allocating decisionmaking authority between federal courts and arbitrators when fraud is asserted as a defense to an arbitration agreement – applies in state court. Therefore, *Southland*'s constitutionally doubtful interpretation of the FAA is directly implicated in this case.

A. *Southland* Suffers from Constitutional Infirmities Comparable to *Swift v. Tyson*

Special circumstances warrant overruling *Southland*. *See Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 284 (1995) (Scalia, J., dissenting) ("proper application of

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ERISA, 29 U.S.C. § 1144(a). But any suggestion that Congress's power to enact a completely preemptive regulatory scheme carries the "lesser included" power of dictating state court procedures suffers from a fundamental flaw. While the purported power to regulate state procedures may represent a lesser *intrusion* on state autonomy than complete preemption of a field, it is not a "lesser included" power, *because it is not "included."* The fact that Congress possesses the nuclear bomb of preemption-plus-exclusive-jurisdiction does not imply that it also possesses a small commando team with "surgical strike" capability. This "lesser included" argument is also a close cousin to the constitutionally dubious theory of "protective jurisdiction," which holds that Congress can give jurisdiction to federal courts over state law claims where Congress could, but has not, preempted state law with substantive federal regulation. This Court has declined to embrace that theory. *See Mesa v. California*, 489 U.S. 121, 137 (1989).

stare decisis does not prevent correction of the mistake" of *Southland*). Justice Brandeis wrote that stare decisis "is not an inexorable command. The instances in which the court has disregarded its admonition are many." *Washington v. W.C. Dawson & Co.*, 264 U.S. 219, 238 (1924) (Brandeis, J., dissenting).[8] Fourteen years later, a majority of the Court joined Justice Brandeis, in *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), to overrule a 96-year-old statutory interpretation precedent, *Swift v. Tyson*, 42 U.S. (16 Pet.) 1 (1842). *Erie* held that *the judicial interpretation* given to section 34 of the 1789 Judiciary Act by *Swift* – not the statute itself – was unconstitutional because it allowed the federal courts to make law on subjects outside the legislative power of Congress.

Southland is not a garden variety error in statutory interpretation, where the Court can rely on Congress to clear up a disagreement over statutory intent.[9] Like *Swift*, *Southland* is a major federalism error that attributes to Congress an intention to intrude on state autonomy to a degree that pushes the FAA beyond the limits of

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[8] "Notwithstanding the rule [of statutory stare decisis], the Supreme Court has overruled or materially modified statutory precedents more than eighty times" between 1961 and 1988. William N. Eskridge, Jr., *Overruling Statutory Precedents*, 76 Geo. L. Rev. 1361, 1427-39 (1988).

[9] It seems problematic to rely on Congress to correct the Court's erroneous statutory interpretation, when the Court errs by attributing *too much* power to Congress. *But see Circuit City Stores v. Adams*, 532 U.S. at 122 (suggesting it is incumbent upon Congress, not the Court, to revisit *Southland*). Such a suggestion runs counter to this Court's reaffirmation of its role as watchman on the boundaries of Congressional power. *See Morrison*, 529 U.S. at 617 n.7. Moreover, even if Congress overrules *Southland*'s statutory interpretation, it cannot undo *Southland*'s implied constitutional interpretation that Congress has the power to regulate state court procedures.

Congressional power. Although *Southland's* FAA is narrower in scope than the general federal law considered in *Erie,* its effect on the states goes deeper: federal common law under *Swift* was not applicable in state court, and state statutes could in effect overrule federal common law decisions. *See Erie*, 304 U.S. at 71 (quoting *Swift*, 42 U.S. (16 Pet.) at 10) ("positive statutes of the state" are rules of decision under § 34). But *Southland* holds that the federal common law of the FAA binds state courts and nullifies state statutes. Thus, *Southland*'s reliance on the FAA – a fundamentally procedural law – as a basis to create a body of federal judge-made law that preempts state lawmaking is arguably even more constitutionally problematic than *Swift.*

B. *Southland*'s Authority Has Been Eroded by Subsequent Decisions of this Court

Southland's authority has been eroded by several subsequent decisions of this Court treating the FAA as procedural. *Rodriguez*, 490 U.S. at 482-83; *accord EEOC v. Waffle House*, 534 U.S. 279, 295 (2002) (arbitration agreement is "effectively a forum selection clause"); *Circuit City Stores v. Adams*, 532 U.S. 105, 123 (2001); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

It may also be quite true that no Justice who has sat on this Court since 1994 even believes *Southland* was correctly decided, whereas five Justices who sat on this Court after 1994 have, at one time or another specifically stated that *Southland* was wrongly decided. *See Southland*, 465 U.S. at 18-21 (Stevens, J., concurring in part

and dissenting in part) (dissenting from proposition that § 2 of the FAA preempts state statutes, as opposed to common-law rules, limiting enforceabilility of arbitration agreements for certain types of cases); 465 U.S. at 24 (O'Connor, J., joined by Rehnquist, J., dissenting) (*Southland* majority wrongly concluded that FAA § 2 created federal substantive rights that must be enforced in state courts); *Allied-Bruce*, (O'Connor, J., concurring) (same); *id.* at 284-85 (Scalia, J., dissenting) ("Adhering to *Southland* entails a permanent, unauthorized eviction of state-court power to adjudicate a potentially large class of disputes"); *id.* at 285 (Thomas, J., joined by Scalia, J., dissenting) ("In my view, the Federal Arbitration Act does not apply in state courts"). While this Court declined to overrule *Southland* ten years ago in *Allied-Bruce*, and while the plurality opinion in *Green Tree Fin. Serv. v. Bazzle*, 539 U.S. 444 (2003), took FAA preemption as a given, in neither case did the Court consider *Southland*'s constitutional infirmities.

C. *Southland*'s Unworkable Test for Preemption Has an Unsettling Effect on the Law That Outweighs Any Legitimate Reliance Interests by Private Contracting Parties

Southland has been construed by this Court as creating a rule that state laws that target arbitration agreements for special barriers to enforcement are preempted, whereas "generally applicable contract defenses" and rules that "arose to govern . . . contracts generally" may be applied to arbitration agreements "without contravening [FAA] § 2." *Doctors Associates v. Casarotto*, 517 U.S. 681, 687 (1996) (quoting *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987)). This distinction between "general contract law"

and "arbitration-specific" rules, which reflects internal contradictions in *Southland*, is incoherent and has defied consistent application in all but the clearest cases. See Schwartz, *Power of Congress, supra* at 554-70.

For instance, some courts have held that laws regulating non-arbitration matters in certain kinds of contracts – such as venue provisions in consumer contracts – are not "generally applicable" because they do not apply to all contracts, and are therefore preempted in arbitration cases. *See, e.g., Bradley v. Harris Research*, 275 F.3d 884 (9th Cir. 2001) (holding FAA preempts venue provision in state franchise law); *KKW Enterprises v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50 (1999) (same); *Doctors Associates v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998) (same). These holdings threaten to undermine broad swaths of state contract regulation. An arbitration agreement could be written to mandate a waiver of injunctive relief, compensatory damages or attorneys' fees guaranteed by a state consumer or antidiscrimination statute: because those statutes are not "general contract law" they would be preempted and the arbitration agreement "enforced as written" under this spin on *Southland*'s "general law" analysis.

Few legitimate expectations are settled by *Southland*. On the contrary, it is clear that, in the past several years, corporate drafters of arbitration agreements have not been resting on settled expectations, but have been aggressively experimenting with arbitration agreements to find new ways to use them to limit their customers' or employees' remedies against them. *See, e.g., Ting v. AT&T*, 182 F. Supp. 2d 902, 924-28 (N.D. Cal. 2002), *aff'd in part, rev'd in part* 319 F.3d 1126 (9th Cir. 2003) (arbitration agreement purported to limit liability for wilful

misconduct, limit or bar compensatory and punitive damages, preclude class actions, and impose secrecy requirements); *Stirlen v. Supercuts*, 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138, 142-43 (1997) (arbitration agreement purported to require adhering party to waive tort damages and attorneys fees, while leaving drafting party free to pursue claims in court).

D. *Southland*'s Imposition of a "National Policy Favoring Arbitration" on the States Intrudes on the State-Federal Balance by Preempting Broad Swaths of State Contract Law

To the extent that cases about arbitration agreements are about something other than procedure, that something is contracts, an area of traditional state regulation which federal courts should be "reluctant to federalize." *Patterson v. McLean Credit Union*, 491 U.S. 164, 183 (1989) (quoting *Santa Fe Industries v. Green*, 430 U.S. 462, 479 (1977)). Since *Southland* was decided in 1984, scores of state laws have been held preempted or become subject to FAA preemption; just since 2002, at least fifty different state laws have been held preempted under *Southland*. David S. Schwartz, *State Judges as Guardians of Federalism: Resisting the Federal Arbitration Act's Encroachment on State Law*, 16 Wash. U. J. L. & Pol. 129, 234 (2004).

The values of federalism, articulated in *Gregory v. Ashcroft*, 501 U.S. 452 (1991), provide a basis for evaluating *Southland*'s federalism error:

> This federalist structure of joint sovereigns preserves to the people numerous advantages. It assures a decentralized government that will be

> more sensitive to the diverse needs of a heterogenous society; it increases opportunity for citizen involvement in democratic processes; it allows for more innovation and experimentation in government; and it makes government more responsive by putting the States in competition for a mobile citizenry.

Gregory, 501 U.S. at 458; *accord United States v. Lopez*, 514 U.S. 549, 552 (1995) (citing *Gregory* as setting forth the "first principles" of federalism); *id.* at 581 (Kennedy, J., concurring) (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (arguing that states can serve as "laboratories for experimentation" in social policy). Each of these values of federalism assumes a substantial degree of state lawmaking autonomy; none would have much meaning if the states were merely "regional offices [ ]or administrative agencies of the federal government." *New York v. United States*, 505 U.S. 144, 188 (1992).

Preemption doctrine represents the most significant and frequently applied limitation on substantive state autonomy in our constitutional scheme. *See* Stephen A. Gardbaum, *The Nature of Preemption*, 79 Corn. L. Rev. 767, 768 (1994). While federal commerce power still potentially reaches most subjects of legislation even after *Lopez* and *United States v. Morrison*, 529 U.S. 598 (2000), preemption doctrine holds that Congress may nullify state law on any subject within federal legislative jurisdiction. Therefore,

> the true test of federalist principle may lie, not in the occasional effort to trim Congress's commerce power at its edges . . . or to protect a state treasury from a private damage action . . . but rather

> in those many statutory cases where courts interpret the mass of technical detail that is the ordinary diet of the law

– namely, preemption cases. *Egelhoff v. Egelhoff*, 532 S. Ct. 141, 161 (2001) (Breyer, J., dissenting).

E. This Court's "Clear Statement" Rule and the Doctrine of Constitutional Avoidance Undermine Any Contention that *Southland* Properly Construes the FAA

Southland plainly violated two well-established principles of statutory construction that should operate to protect federalism and state autonomy in the application of the FAA. A well-established principle of judicial restraint, the doctrine of constitutional avoidance, holds that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Solid Waste Agency of Northern Cook County v. Army Corps of Engineers*, 531 U.S. 159, 173 (2001) (internal quotations omitted) (narrowly construing the federal Clean Water Act to avoid federalism-based constitutional question). As shown above, *Southland*'s imposition of a fundamentally procedural federal law on the states raises serious constitutional objections that are sufficient to reject the *Southland* interpretation of the FAA as preemptive substantive law.

Likewise, this Court held in *Gregory* that "[i]f Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention unmistakably clear in the language of

the statute." 501 U.S. at 460 (internal quotations omitted). This "clear statement" rule has long been applied in preemption cases: "'where . . . the field which Congress is said to have preempted includes areas that have been traditionally occupied by the States,' congressional intent to supersede state laws must be 'clear and manifest.'" *Allied-Bruce*, 513 U.S. at 283 (O'Connor, J., concurring) (quoting *English v. General Electric Co.*, 496 U.S. 72, 78-79 (1990)). "To the extent that federal statutes are ambiguous, we do not read them to displace state law." *Allied-Bruce*, 513 U.S. at 292 (Thomas, J., dissenting); *accord Southland*, 465 U.S. at 18 (Stevens, J., concurring in part and dissenting in part) ("The exercise of state authority in a field traditionally occupied by state law will not be deemed pre-empted by a federal statute unless that was the clear and manifest purpose of Congress").

Does the FAA include a "clear statement" of Congressional intent to preempt state law, as would be required under *Gregory*? No. It is widely recognized that the "national policy favoring arbitration" was not the creation of the FAA as written by Congress, but was instead a judicial creation – federal common law – that took the FAA as a point of departure. *See Allied-Bruce*, 513 U.S. at 283 (O'Connor, J., concurring) ("the Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation"). As has been clearly demonstrated in two scholarly dissenting opinions from this Court, the *Southland* opinion flouted the FAA's historical record, which showed that Congress intended the FAA to be a procedural statute that neither applied in state court nor preempted state law. *See Allied-Bruce*, 513 U.S. at 285-95 (Thomas, J., dissenting); *Southland*, 465

U.S. at 23-31 (O'Connor, J., dissenting).[10] But even the *Southland* majority opinion conceded the absence of anything that would meet the "clear statement" test, when it went outside the FAA's text to rely on a legislative history that was "not without ambiguities." 465 U.S. at 12.

There is no question that were *Southland* being decided for the first time today, this Court would apply *Solid Waste Agency* and *Gregory* to reject the argument that the FAA is substantive law binding on the states.

CONCLUSION

Southland's rule of Federal Arbitration Act preemption "entails a permanent, unauthorized eviction of state-court power to adjudicate a potentially large class of disputes." *Allied Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 284-85 (1995) (Scalia, J., dissenting). It is time that *Southland* be overruled. Amici respectfully submit that, on this basis, this Court affirm the decision below.

Dated: September 23, 2005

Respectfully submitted,

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[10] For additional historical evidence supporting the arguments in the O'Connor and Thomas dissents, *see* David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: the Supreme Court and the Federal Arbitration Act*, 67 Law & Contemp. Prob. 5 (2004).

OCT 25 2005

No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

On Writ of Certiorari to the Supreme Court of Florida

REPLY BRIEF FOR PETITIONER

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October 25, 2005

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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INTRODUCTION

Plaintiffs effectively ask this Court to overrule not just one but two landmark decisions that have governed the enforceability of arbitration agreements in this Nation for decades: (1) *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), and (2) *Southland Corp. v. Keating*, 465 U.S. 1 (1984). In *Prima Paint*, this Court held as a matter of federal substantive law that a challenge to the validity of an underlying contract is severable from a challenge to the validity of an embedded arbitration clause, and in *Southland*, this Court held that federal substantive law governing arbitrability applies in state courts. Those two precedents control the resolution of this case: under the Federal Arbitration Act ("FAA"), plaintiffs cannot avoid enforcement of their arbitration agreement in either federal or state court by challenging the underlying contract on grounds unrelated to the arbitration agreement.

Plaintiffs insist, however, that *Prima Paint*'s severability rule is not a rule of federal substantive law, but "a matter of federal court procedure ... that applies *only* in federal court proceedings." Resp. Br. 18 (emphasis in original). Putting aside the fact that plaintiffs failed to advance this argument in their opposition to the petition for certiorari (or at any other point in these proceedings), the argument is squarely inconsistent with the FAA as interpreted in *Prima Paint*. That case specifically held that the severability of an arbitration clause is "substantive" federal law enacted under the Commerce Clause, *see* 388 U.S. at 400, 404-05, and this Court subsequently built on that holding by specifying that the substantive federal law of arbitration applies in state as well as federal court, *see Southland*, 465 U.S. at 11-12. Plaintiffs may disagree with *Prima Paint* and *Southland*, but they cannot pretend that those cases did not hold what they did.

Nor can plaintiffs sidestep *Prima Paint* by arguing that its federal severability rule does not come into play if the underlying contract is challenged as void, rather than voidable,

under state law. The whole point of the rule is that a party cannot avoid an arbitration agreement by simply challenging the underlying contract in which it is embedded. The *nature* of the challenge to the underlying contract, and the state-law severability implications of that challenge, are immaterial; what matters is that the challenge is directed at the underlying contract, as opposed to the arbitration clause itself. To say that *Prima Paint*'s federal severability rule does not come into play until *after* a court applies a state severability rule is, for all intents and purposes, to deny the federal rule. Thus, contrary to plaintiffs' assertion, the issue here is not whether to adopt a "new rule of federal contract law," Resp. Br. 9; rather, it is whether to retain an old rule of federal arbitration law.

Let there be no mistake about it: the issue here is not (as plaintiffs repeatedly assert, *see, e.g.*, Resp. Br. 1, 7, 8, 18, 19, 20, 35) whether to "extend" *Prima Paint*, but whether to gut that decision (as well as *Southland*). At bottom, plaintiffs (and their *amici*, who are more candid on this score) are arguing that those cases were wrongly decided, and that the FAA neither establishes federal substantive law nor applies in state court. Those arguments, however, are addressed to the wrong forum. If plaintiffs and their *amici* do not like these longstanding statutory precedents, upon which innumerable contracts have been based, they are free to make their case to Congress. But they have provided no reason for this Court to do their work for them.

The reason that *Prima Paint* and *Southland* have stood the test of time is no mystery: those decisions are eminently sensible. The federal severability rule prevents parties from avoiding their agreements to arbitrate by challenging their underlying contracts on grounds unrelated to arbitration, and the application of that substantive rule in state as well as federal court prevents forum shopping. In sharp contrast to the indeterminate and inconsistent approach suggested by plaintiffs,

this regime is workable and predictable—which may explain why all six federal circuits confronted with the question presented here had no trouble concluding (without dissent) that *Prima Paint*'s federal severability rule governs a challenge to an underlying contract based on illegality. This Court should decline plaintiffs' invitation to overturn this settled law.

ARGUMENT

I. *Prima Paint* Established A Substantive Rule Of Federal Law Applicable In Both Federal And State Court.

Plaintiffs argue as a threshold matter that *Prima Paint*'s federal severability rule does not apply here at all, because this case arises from state, not federal, court. *See* Resp. Br. 13-19. That argument fails on both procedural and substantive grounds.

A. Plaintiffs Waived The Argument That *Prima Paint* Does Not Apply In State Court.

As an initial matter, plaintiffs waived the argument that *Prima Paint* does not apply in state court by failing to raise that argument in their opposition to the petition (or at any other previous stage of this litigation). The petition presented the question whether the Florida Supreme Court erred by deciding this case "consistent with the Alabama Supreme Court but in direct conflict with six federal courts of appeals." Pet. i. If plaintiffs believed that this alleged conflict was illusory because *Prima Paint* does not apply in state court at all, they were required to say so in their opposition brief. *See, e.g.*, S. Ct. Rule 15.2; *Baldwin v. Reese*, 541 U.S. 27, 34 (2004); Robert L. Stern *et al.*, *Supreme Court Practice* § 6.37, at 450-51 (8th ed. 2002). Plaintiffs, however, said nothing of the sort; rather, they acknowledged the conflict and simply argued that the contrary federal decisions were "mistaken," "indefensible," and "simply wrong." Pet. Opp. 21-22. Because plaintiffs' new argument does not relate to *this* Court's power to decide the case, and

hence is not "jurisdictional," this Court should deem it waived. *See, e.g., South Cent. Bell Tel. Co. v. Alabama*, 526 U.S. 160, 171 (1999); *Oklahoma City v. Tuttle*, 471 U.S. 808, 816 (1985).

Plaintiffs offer three reasons why their new argument "is properly before the Court," Resp. Br. 13-14 n.4, but none is availing. *First*, plaintiffs contend that the Florida Supreme Court "explicitly addressed" the argument. *Id.* That contention is simply untrue: the Florida court attempted to distinguish *Prima Paint* on the merits, but never suggested that the case did not apply in state court at all. *See* Pet. App. 5a-7a. *Second*, plaintiffs invoke "this Court's traditional rule that once a federal claim is properly presented, a party can make any argument in support of that claim." Resp. Br. 14 n.4 (internal quotation omitted). But that rule on its face does not apply here, where the disputed "federal claim" is *Buckeye*'s claim that the FAA requires arbitration of the underlying lawsuit. Instead, plaintiffs are governed by the rule that "the prevailing party ... is entitled to defend the judgment on any ground *that it properly raised below*," *Jones v. United States*, 527 U.S. 373, 396 (1999) (emphasis added), which does not help them because they never raised this argument below. *Third*, plaintiffs assert that their new argument is "predicate to an intelligent resolution of the question presented." Resp. Br. 14 n.4 (internal quotation omitted). But plaintiffs' new argument applies only to cases in state court, and the question presented here also arises in federal court, so it can be "intelligently resolved" without addressing the new argument.

B. *Prima Paint* Applies in State Court.

If this Court nonetheless exercises its discretion to reach the merits of plaintiffs' new argument that *Prima Paint* does not apply in state court, that argument can readily be dismissed. Plaintiffs contend that *Prima Paint*'s federal severability rule is merely "a rule of *procedure* governing the allocation of authority between federal courts and arbitrators that Congress

created pursuant to its power to regulate proceedings in federal courts." Resp. Br. 16 (emphasis added); *see also id.* at 18 ("[T]he separability rule [of *Prima Paint*] is a matter of federal court procedure."). That contention is manifestly incorrect.

The very question presented in *Prima Paint* was whether the FAA establishes a *substantive* federal severability rule that preempts contrary state law. This Court unequivocally answered that question in the affirmative, "agree[ing]" with the Second Circuit that the severability rule is "one of 'national substantive law'" that "governs even in the face of a contrary state rule," 388 U.S. at 400 (and rejecting the First Circuit's contrary view that "the question of 'severability' is one of state law," *id.* at 403). Contrary to plaintiffs' assertion, *Prima Paint* did not hold that the FAA was based on Congress' power over the federal courts, but instead on Congress' commerce power. *See id.* at 405 ("[I]t is clear beyond dispute that the federal arbitration statute is based upon and confined to the incontestable federal foundations of control over interstate commerce and over admiralty.") (internal quotation omitted).

If *Prima Paint* itself left any doubt on this score, moreover, subsequent rulings have dispelled it. In *Southland*, this Court reaffirmed *Prima Paint*'s holding that the FAA creates substantive federal law enacted under Congress' commerce power. *See* 465 U.S. at 11 ("The [FAA] rests on the authority of Congress to enact substantive rules under the Commerce Clause."); *id.* ("The [*Prima Paint*] Court relied for [its] holding on Congress' broad power to fashion substantive rules under the Commerce Clause."). Indeed, as *Southland* noted, the statutory requirement of a "contract evidencing a transaction involving commerce," 9 U.S.C. § 2, would be inexplicable if the statute were *not* enacted under Congress' commerce power. 465 U.S. at 14. *Southland* further made explicit "what was implicit in *Prima Paint*, *i.e.*, the substantive law the Act created [is] applicable in state and federal court." *Id.* at 12.

And in *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995), this Court reaffirmed not only *Prima Paint*'s holding that the FAA establishes "substantive" federal law enacted under the Commerce Clause, *id.* at 271, but also *Southland*'s holding that such substantive federal law applies in both state and federal court, *see id.* at 271-72.

Because *Southland* and *Allied-Bruce* leave no doubt that the FAA's substantive provisions apply in state as well as federal court, plaintiffs try to circumvent those cases by arguing that *Prima Paint*'s federal severability rule is not substantive at all. According to plaintiffs, "*Prima Paint*'s holding was grounded in the language of 9 U.S.C. § 4," which they claim is merely a procedural provision governing the enforcement of arbitration agreements in federal court. Resp. Br. 6. That argument is not only incorrect but perverse, since (as noted above) the very foundation for *Southland*'s holding that the FAA's substantive provisions apply in state court was *Prima Paint*'s antecedent holding that the FAA created substantive federal law (specifically, a severability rule) in the first place.

Thus, even assuming that plaintiffs are correct in arguing that § 4 of the FAA does not apply of its own force in state court—an issue this Court expressly left open in *Southland*, *see* 465 U.S. at 16 n.10—that argument misses the point. This case is not about the arguably procedural provisions of § 4, but about the indisputably substantive provisions of § 2. Statutes must be read as a whole, and FAA § 4 gives meaning to FAA § 2. *See, e.g., Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 201 (1956) (FAA sections "are integral parts of a whole" that must be read together); *cf. Prima Paint*, 388 U.S. at 400 ("The key statutory provisions are §§ 2, 3, and 4 of the [FAA]."). Although § 2 on its face focuses on the enforceability of the arbitration "provision" itself, and thus suggests that this issue is distinct from the enforceability of the underlying "contract," that section itself did not expressly answer the severability

question presented in *Prima Paint*. Not surprisingly, the Court thus turned for guidance to the other sections of the statute. Because § 4 orders a federal court to compel arbitration once the "the making of *the agreement for arbitration* or the failure to comply therewith is not in issue," 9 U.S.C. § 4 (emphasis added), it logically follows that the "grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C. § 2, which a court may consider before enforcing the arbitration agreement, are limited to grounds involving the arbitration agreement itself (as opposed to the underlying contract).

Indeed, plaintiffs' argument that *Prima Paint*'s severability rule is "procedural" rather than "substantive" in nature turns those terms upside down. Whether a particular contractual provision is severable from the underlying contract has nothing to do with judicial "procedure," and everything to do with "substance." That is why *Prima Paint*'s rule preempts contrary state substantive law, *see* 388 U.S. at 402-04, and why that rule applies in state as well as federal court (as the court below assumed and many state courts have recognized, *see*, *e.g.*, *Eddings v. Southern Orthopedic & Musculoskeletal Assocs., P.A.*, 555 S.E.2d 649, 655 (N.C. App. 2001), *rev'd on other grounds*, 569 S.E.2d 645 (N.C. 2002); *Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 604 So. 2d 332, 336-37 (Ala. 1991)). Plaintiffs tellingly do not cite a single decision under the FAA holding that *Prima Paint* does not apply in state court.

As a policy matter, of course, the foregoing conclusion is eminently sensible, since there would be little to recommend a rule that treated arbitration clauses as severable in federal court but not in state court (particularly since parties have no way of knowing *ex ante* if an eventual dispute will wind up in federal or state court). Under plaintiffs' regime, an arbitration agreement would be enforced in a diversity case filed in or removed to federal court, but not in the state court across the street. Such a rule would only encourage the very forum-

shopping and gamesmanship that this Court rejected in *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78-79 (1938), by holding that federal courts sitting in diversity should not apply different substantive law than state courts. Indeed, this compelling consideration underlies *Southland*, which recognized that it would be most odd to think that Congress exercised its powers under the Commerce Clause to create federal substantive arbitrability law, but then limited such law to the federal courts. 465 U.S. at 15-16; *see also Allied-Bruce*, 513 U.S. at 272; *cf. Prima Paint*, 388 U.S. at 424-25 (Black, J., dissenting); *Bernhardt*, 350 U.S. at 203-04.

Several of plaintiffs' *amici* are candid enough to admit that their real grievance is not with the application of *Prima Paint per se* in state court, but with the application of *any* provision of the FAA in state court. In their view, both *Southland* and *Allied-Bruce* (not to mention *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003); *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996); *Volt Info. Scis., Inc. v. Board of Trs. of the Leland Stanford Jr. Univ.*, 489 U.S. 468 (1989); and *Perry v. Thomas*, 482 U.S. 483 (1987), all of which applied the substantive provisions of the FAA in cases arising from state court), should be overruled. This Court can readily dispose of that argument.

As an initial matter, the *Southland* line of cases flows inexorably from *Prima Paint*'s holding that the FAA established substantive federal law enacted under the commerce power. Indeed, in light of *Prima Paint*, most state courts recognized even *before Southland* that the FAA applies in state court. *See, e.g., Burke Cty. Pub. Schs. Bd. of Ed. v. Shaver P'ship*, 279 S.E.2d 816, 824 & n.15 (N.C. 1981) (collecting cases); *cf. Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 407 (2d Cir. 1959) (FAA's substantive severability rule applies in both federal and state court), *cert. granted*, 362 U.S. 909, *cert. dismissed*, 364 U.S. 801 (1960).

The *amici* who urge this Court to overrule *Southland* have no answer to the obvious question why Congress would have wanted to establish substantive federal law applicable only in federal court, thereby leaving state courts free to discriminate against and otherwise thwart arbitration at will. To make their *Southland* argument, thus, *amici* fall back on the theory that the FAA simply established procedural rules governing the enforcement of arbitration agreements in federal court. But that argument is directed not against *Southland*, but against *Prima Paint*.

The relevant question, however, is not whether either *Prima Paint* or *Southland* was correctly decided as an original matter, but whether the proponents of overruling either or both of those cases have met their heavy burden of justifying such an extraordinary step. They have not even come close. "Time and time again, this Court has recognized that the doctrine of *stare decisis* is of fundamental importance to the rule of law." *Hilton v. South Carolina Pub. Rys. Comm'n*, 502 U.S. 197, 202 (1991) (internal quotation omitted); *see also id.* ("Adherence to precedent promotes stability, predictability, and respect for judicial authority.").

Prima Paint has been on the books for almost four decades, and *Southland* for more than two. Just over a decade ago, this Court expressly considered, and squarely rejected, a request to overrule *Southland*. *See Allied-Bruce*, *see* 513 U.S. at 271-72. Congress has shown no inclination to amend the FAA in light of any of those decisions. As this Court has stated time and again, *stare decisis* is at its zenith in statutory cases—especially where, as here, private contracts are written in reliance on a particular interpretation of a statute. *See, e.g., Payne v. Tennessee*, 501 U.S. 808, 828 (1991); *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-73 (1989); *cf. Allied-Bruce*, 513 U.S. at 283-84 (O'Connor, J., concurring). Indeed, in its most recent decision applying the FAA in a case arising from

state court, this Court did not even address the argument presented by *amici* that the *Southland* line of cases should be overruled. *See Bazzle*, 539 U.S. at 444. It would be particularly inappropriate to take such a dramatic and expectation-upsetting step where, as here, that issue was not even raised at the petition stage (and hence petitioner had no reason to address this issue in its opening brief, and no *amicus* had any reason to address that issue on petitioner's behalf).[1] Accordingly, this Court should decline the invitation to topple the entire edifice of substantive federal arbitration law.

II. The Application Of *Prima Paint*'s Severability Rule Does Not Depend On The Ground On Which The Underlying Contract Is Challenged.

Plaintiffs next argue that *Prima Paint*'s federal severability rule does not apply where, as here, the underlying contract containing an arbitration clause is challenged on grounds that would render it *void* (as opposed to *voidable*) under state law. Again, they are mistaken.

The whole point of *Prima Paint* is that a challenge to the validity of an underlying contract is severable from a challenge to the validity of an embedded arbitration agreement: as long as the party is not challenging the making of the arbitration agreement, any challenge to the underlying contract must be presented to the arbitrator in the first instance. *See* 388 U.S. at 402-04. That rule advances the strong federal policy favoring arbitration by preventing parties (like plaintiffs here) from

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[1] Indeed, this case does not even squarely present the issue whether the FAA applies of its own force in state court, because the parties here *agreed in their contract* that "[t]his arbitration Agreement ... shall be governed by the Federal Arbitration Act ('FAA'), 9 U.S.C. Sections 1-16." JA 36, 38, 40, 42. Where parties agree to be governed by the FAA (or, conversely, not to be governed by the FAA, *see, e.g., Volt*, 489 U.S. at 478-79), there is no reason not to respect that agreement. Thus, regardless of one's views regarding *Southland*, *cf. Bazzle*, 539 U.S. at 460 (Thomas, J., dissenting), the FAA should apply here.

evading their arbitration obligations by simply challenging the underlying contract on grounds (like usury) unrelated to the arbitration agreement. *See id.* at 404.

Plaintiffs recognize that *Prima Paint* "hold[s] that the FAA creates a separability rule," Resp. Br. 14, and do not purport to dispute that rule. Rather, they contend, before a court applies the federal severability rule, it must first entertain any challenge to the underlying contract that, under state contract law, would render the underlying contract void *ab initio*. *See id.* at 20-25. That approach is commanded, they assert, by the "plain language" of FAA § 2. *Id.* at 2, 19, 20. In their view, an arbitration provision embedded in a contract that is void *ab initio* under state law is not an arbitration provision "in" or "arising from" a "contract" within the meaning of § 2. *See id.* at 20-25; *see also id.* at 27 ("[T]he language of the FAA require[s] that a court find that a 'contract' exists *before* attempting to enforce the FAA.") (emphasis in original).

That approach turns *Prima Paint* on its head: to argue that *Prima Paint*'s federal severability rule does not come into play until *after* a court resolves a challenge to the underlying contract, and applies a state severability rule, is to negate the federal rule. If a court must entertain a challenge to the underlying contract before enforcing the arbitration clause, then the arbitration clause is not severable. Nothing in *Prima Paint*, however, remotely suggests that the *nature* of the challenge to the underlying contract (or the state-law severability implications of that challenge) has any bearing on the operation of the federal severability rule. Indeed, a principal virtue of that rule is that it can be applied (and arbitration enforced) *without regard* to the validity or enforceability of the underlying contract.

In essence, thus, plaintiffs are asking this Court to hold that the FAA does not create a federal substantive rule of severability, so that the severability inquiry turns on state law.

See, e.g., Resp. Br. 31 ("Far from creating a federal rule that might conflict with Florida law in this case, the FAA *entrusts* states with determining the law in this area.") (emphasis in original). Whatever the merits of that argument as an original matter, it is squarely inconsistent with *Prima Paint*. Indeed, plaintiffs' position is essentially indistinguishable from Justice Black's dissent in *Prima Paint*, which sharply criticized the Court for "hold[ing] that the [FAA], as a matter of federal substantive law, compels a party to a contract containing a written arbitration provision to carry out his 'arbitration agreement' even though a court might ... hold the entire contract—including the arbitration agreement—*void* because of fraud in the inducement." 388 U.S. at 407; *see also id.* ("The Court holds, what is to me fantastic, that the legal issue of a contract's *voidness* because of fraud is to be decided by persons designated to arbitrate factual controversies arising out of a valid contract between the parties.") (emphasis added).

Plaintiffs' assertion that the "plain language" of § 2 commands a different result here than in *Prima Paint*, Resp. Br. 2, 19, 20, is baseless. Plaintiffs place quotation marks around the word "contract" in the text of the statute to suggest that the word creates a "threshold" requirement for a court to entertain challenges to the underlying contract, Resp. Br. 7, 8, 11, 15, 19, 25, 30, even where, as here, those challenges do not relate to the arbitration provision. But this novel "textual" argument—which no court has ever addressed, much less adopted—is entirely question-begging. The statute does not say, as plaintiffs would have it, that the arbitration provision must be included in a *legally valid* and *enforceable* "contract." That was the very issue in *Prima Paint*, where the plaintiff sought rescission of the entire contract under state law on the ground of fraud in the inducement. The *Prima Paint* Court did not begin its analysis by considering whether a rescission suit under New York law negated the existence of a "contract." To the contrary, the Court candidly admitted that it did not care about the

implications of a rescission suit under New York state law—an issue that was "not entirely clear." 388 U.S. at 400 n.3. Rather, because the Court decided that the severability issue was governed by federal law under the FAA, it "need[ed] not decide the status of the issue under New York law." *Id.*

Indeed, by focusing on the word "contract" in isolation, plaintiffs read the statute out of context. Precisely because the FAA (as noted above) was enacted under the Commerce Clause, the statute on its face applies only to an arbitration provision in "a contract evidencing a transaction involving commerce." 9 U.S.C. § 2. Contrary to plaintiffs' position, thus, the key issue is not whether there is an underlying "contract" *per se*—which is a given—but whether that contract "evidenc[es] a transaction involving commerce." If the existence of a legally valid and enforceable "contract" under state law were a prerequisite to application of the FAA, then *Prima Paint* would have had to grapple with this issue, and (if the *Prima Paint* petitioner's description of New York rescission and severability law was correct, *see* Br. for Pet'r 21-22 & n.15, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (No. 66-343), Reply Br. for Pet'r 7-10, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (No. 66-343)) would have come out the other way. Indeed, Justice Black dissented on just this ground. *See id.* at 412-13 ("Sections 2 and 3 of the Act assume the existence of a *valid* contract. They merely provide for enforcement where such a *valid* contract exists.") (emphasis added); *id.* at 421 ("Under New York law, ... general allegations of fraud in the inducement would, as a matter of state law, put in issue the making of the arbitration clause.").

Plaintiffs' suggestion that *Prima Paint* created a unique federal rule for fraud-in-the-inducement challenges thus fails on its own terms. Under plaintiffs' approach, a court asked to compel arbitration must in every case analyze a challenge to an

underlying contract under state law to determine whether that challenge implicates "contract formation." Resp. Br. 6, 8, 10, 18, 30-31, 46. That would be true even where, as in *Prima Paint*, the contract is challenged on fraud-in-the-inducement grounds, because it is obviously possible for a State to have a rule that fraud in the inducement (at least where, as in *Prima Paint* itself, rescission is sought) negates the formation of a "contract." *See, e.g., Henderson v. Coral Springs Nissan, Inc.*, 757 So. 2d 577, 578 (Fla. Dist. Ct. App. 2000) ("[R]escission ... makes a contract void in its inception as though it never existed."); *cf. Prima Paint*, 388 U.S. at 412 (Black, J., dissenting) ("If the contract was procured by fraud, then, unless the defrauded party elects to affirm it, *there is absolutely no contract*, nothing to be arbitrated.") (emphasis added). The "void/voidable" distinction proposed by plaintiffs, in other words, does not provide a basis for distinguishing *Prima Paint*, because that distinction is based on *state* law whereas *Prima Paint* is based on *federal* law. That is why plaintiffs are necessarily asking this Court to replace *Prima Paint*'s federal severability rule with state law.[2]

Plaintiffs thus suggest, without admitting it, that *Prima Paint* itself conflicts with the "plain language" of the FAA, which requires courts to deem arbitration provisions "valid,

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[2] It is simply not true, as plaintiffs assert, that "[i]n *Prima Paint*, this Court faced a situation where a contract *unquestionably* existed." Resp. Br. 20 (emphasis modified); *see also id.* (asserting that in *Prima Paint* "there [was] *no dispute* that a contract ha[d] been formed") (emphasis modified); Br. of Law Professors as *Amici Curiae* in Support of Resps. 9 ("In *Prima Paint, no issue was raised* as to whether there was a contract.") (emphasis added). As noted in the text, that issue was indeed disputed—not least of all, in Justice Black's vigorous dissent. *See* 388 U.S. at 412-13, 421. Plaintiffs' argument that "Buckeye puts the cart before the horse: it demands that courts assume that an arbitration provision meets the requirements of § 2 and enforce the clause, before the court has resolved the threshold question of whether a contract exists at all," Resp. Br. 25, is thus an argument against *Prima Paint*, not an argument for distinguishing that case.

irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*" 9 U.S.C. § 2 (emphasis added). Plaintiffs' position boils down to the proposition that the "grounds ... for the revocation of any contract" include non-severability. But non-severability is not a ground "for the revocation of any *contract*," *id.* (emphasis added); rather, it is a ground for denying effect to provisions embedded *within* a contract. Again, were that not so, *Prima Paint* itself would have come out the other way, because the plaintiff there was indeed seeking to "revo[ke]" the underlying contract. As noted above, the whole point of *Prima Paint* is that an arbitration clause must be treated as distinct from the underlying contract in which it is embedded, so that the "grounds ... for the revocation of any contract" are limited to grounds *specific to the arbitration agreement itself.* Justice Cantero made precisely this point in his dissent below, explaining that the FAA "treat[s] arbitration clauses not as a class of 'super' clauses, but as a class of *separate* clauses—separate, that is, from the other clauses in a contract." Pet. App. 20a (dissenting opinion; emphasis in original). Thus, regardless of state severability law, the FAA does not allow a party to transfer any "taint" from an underlying contract to the arbitration provision; once it is clear that the party is not challenging the making of the arbitration provision itself, the court's role is at an end.

Prima Paint thus refutes plaintiffs' efforts to use the word "contract" as a Trojan horse to smuggle into the § 2 analysis all of the various grounds for challenging a contract under state law. *See, e.g.*, Resp. Br. 22 ("Whenever two parties assent to something, they may have an agreement, but that does not mean that they have a 'contract.'"). Parties may challenge a contract on any number of grounds under state law—*e.g.*, fraud in the inducement, illegality, violation of public policy, lack of essential terms, lack of consideration, or lack of mutuality—but they may not challenge an arbitration provision on grounds

unrelated to that provision. Thus, where (as in *Prima Paint* and here) it is clear that the parties have agreed to arbitrate their dispute, that challenge must be presented to the arbitrator in the first instance.[3]

Indeed, as *Prima Paint* recognized, a contrary rule would undermine "the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." 388 U.S. at 404; *see also Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983) (noting "Congress's clear intent, in the Arbitration Act, to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible"). The whole point of arbitration is to minimize the cost and delay of litigation. Forcing the parties into protracted litigation over whether the case belongs in arbitration in the first place obviously defeats that purpose—just as protracted litigation over immunity would defeat the whole purpose of immunity, *see, e.g., Mitchell v. Forsyth*, 472 U.S. 511, 526 (1985). This case is a perfect example: for a court to resolve what plaintiffs call their

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[3] Plaintiffs cannot, and do not, dispute the premise on which the petition was granted: that their challenge is directed entirely at the allegedly usurious terms of the underlying contract, and relates to the embedded arbitration agreement only insofar as state law would deem the latter agreement inseverable from the underlying contract. In particular, plaintiffs do not deny as a factual matter that they assented to arbitration, or challenge any provision of the arbitration agreements themselves (as opposed to the underlying contracts) as illegal or otherwise unenforceable. *See, e.g.*, Pet. App. 12a ("Cardegna does not dispute that he assented to the arbitration agreement.") (Bell, J., specially concurring); Pet. App. 32a ("Here, appellees did not argue that they did not enter into the arbitration agreement."); Pet. App. 10a ("It is also important to note that Cardegna does not claim that the arbitration clause itself (separately, as opposed to the contract as a whole) somehow is invalid.") (Bell, J., specially concurring); Pet. App. 28a ("[A]t the hearing before the trial court, [plaintiffs] did not argue that the arbitration provision was unconscionable. Accordingly, the issue of unconscionability is not properly before this court for review.").

"threshold" challenge to the legality of the underlying contracts, Resp. Br. 7, 8, 11, 15, 19, 25, 30, would be for the court to resolve the entire case. That is why the FAA "calls for a summary and speedy disposition of motions or petitions to enforce arbitration clauses," *Moses H. Cone*, 460 U.S. at 29, and the *Prima Paint* severability rule promotes such disposition. As this Court asked rhetorically in *Allied-Bruce*: "Why would Congress intend a test that risks the very kind of costs and delay through litigation (*about the circumstances of contract formation*) that Congress wrote the Act to help the parties avoid?" 513 U.S. at 278 (emphasis added).

In light of *Prima Paint*, plaintiffs' heavy reliance on the background "presumption against preemption"—which plaintiffs actually deem "decisive" here, Resp. Br. 6—is thus mystifying. It is certainly true, as a general matter, that courts should not lightly interpret federal statutes to displace state law. But that general maxim (to which plaintiffs devote the entire first section of their argument, *see* Resp. Br. 9-13) adds nothing to the analysis here. *Prima Paint* crossed the preemption bridge by holding that the FAA creates a federal substantive rule of severability that preempts inconsistent state law. Plaintiffs here may not like that rule, but they are not writing on a blank slate. Invoking the "presumption against preemption" provides no basis for gutting *Prima Paint*.

It is no answer to argue, as plaintiffs do, that "arbitration clauses are governed by state, not federal, contract law except in those instances where state law targets arbitration clauses for treatment that is inferior to other types of contracts." Resp. Br. 32; *see also id.* at 33 ("[T]he FAA merely places arbitration agreements on the same footing as other agreements."). Once again, that argument is squarely inconsistent with *Prima Paint*, which held that the FAA preempts state severability law *without regard* to whether that law discriminates against arbitration. *See* 388 U.S. at 402-04. Thus, while it is certainly true that the

FAA preempts state laws that discriminate against arbitration, it is not true that the FAA preempts *only* state laws that discriminate against arbitration. Rather, *Prima Paint* teaches that the FAA also preempts general state severability law to the extent it would treat a challenge to an underlying contract as inseverable from a challenge to an arbitration agreement.

Plaintiffs thus miss the point by insisting that "many jurisdictions have embraced a principle of non-separability for illegal contracts." Resp. Br. 38. New York may have embraced a principle of non-separability for fraudulently induced contracts (at least where the allegedly defrauded party sought rescission), *see* 388 U.S. at 400 & n.3; *see also id.* at 410-11, 421 (Black, J., dissenting), but the *Prima Paint* Court did not care. Rather, *Prima Paint* held that severability under the FAA does not turn on the vagaries of state severability law. Under *Prima Paint*, as noted above, a party is free to attack an arbitration agreement "upon such grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C. § 2, as long as those grounds are directed at the agreement itself, and not the underlying contract. The "non-separability principle" upon which plaintiffs rely, *see* Resp. Br. 39, is thus alien to the FAA, which treats arbitration agreements as distinct from the underlying contracts in which they are embedded.

For this reason, plaintiffs err by arguing that "to enforce a right arising from an illegal contract is to reward, and thus to encourage, unlawful ... behavior," and that "the integrity of the courts themselves would be compromised by the judicial sanction of unlawful contracts." Resp. Br. 39-40. A court asked to compel arbitration under the FAA has no roving commission to inquire into the validity or enforceability of the underlying contract; rather, its role is limited to resolving any disputes relating specifically to the arbitration agreement. And precisely because the court is not addressing the validity or enforceability of the underlying contract, it does not become a

"handmaid of iniquity," Resp. Br. 40 (internal quotation omitted), by simply enforcing the arbitration agreement. Thus, plaintiffs' "hypothetical agreements providing for the sale of cocaine, or the making of child pornography, or a murder-for-hire," Resp. Br. 41, prove nothing. In the unlikely event that the parties to such an agreement included an arbitration provision therein, and no party challenged that provision itself, the arbitrator would presumably determine in short order that the contract was unenforceable and a reviewing court (in the event that the arbitrator's decision was challenged) would readily affirm. This regime in no way promotes illegality; rather, it promotes arbitration.

Indeed, a contrary regime would effectively nullify the FAA's pro-arbitration policy. Although plaintiffs insist that this case is "unique," Resp. Br. 45, it is not. Plaintiffs' theory is that a court must resolve any challenge that goes to the "formation" of an underlying contract under state law *before* compelling arbitration. *See id.* at 20-25. That theory is in no way limited to challenges based on illegality; it presumably would also extend to challenges based on alleged inconsistency with "public policy," *see, e.g.*, *Vacation Beach, Inc. v. Charles Boyd Constr., Inc.*, 906 So. 2d 374, 377 (Fla. Dist. Ct. App. 2005), lack of essential terms, *Glosser v. Vasquez*, 898 So. 2d 1179, 1181 (Fla. Dist. Ct. App. 2005), lack of consideration, *Office Pavilion S. Fla., Inc. v. ASAL Prods., Inc.*, 849 So. 2d 367, 370 (Fla. Dist. Ct. App. 2003), lack of mutuality, *see, e.g.*, *D.L. Peoples Group, Inc. v. Hawley*, 804 So. 2d 561, 563 (Fla. Dist. Ct. App. 2002), or any of the other myriad grounds for challenging the formation of a contract.

Thus, it is simply not true that "[a] ruling for Plaintiffs here will only affect businesses whose contracts are *wholly illegal*," Resp. Br. 45 (emphasis added), which is presumably why the Chamber of Commerce of the United States of America, the American Financial Services Association, and the American

Bankers Association, among others, have filed *amicus* briefs supporting Buckeye's position in this case. At bottom, plaintiffs are inviting this Court to overturn the predictable, workable, and uniform arbitration regime that has been in place for decades, and this Court should decline that invitation.

CONCLUSION

For the foregoing reasons, the judgment of the Florida Supreme Court should be reversed.

Respectfully submitted,

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October 25, 2005

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

BUCKEYE CHECK CASHING, INC. *v.* CARDEGNA ET AL.

CERTIORARI TO THE SUPREME COURT OF FLORIDA

No. 04–1264. Argued November 29, 2005—Decided February 21, 2006

For each deferred-payment transaction respondents entered into with Buckeye Check Cashing, they signed an Agreement containing provisions that required binding arbitration to resolve disputes arising out of the Agreement. Respondents sued in Florida state court, alleging that Buckeye charged usurious interest rates and that the Agreement violated various Florida laws, rendering it criminal on its face. The trial court denied Buckeye's motion to compel arbitration, holding that a court rather than an arbitrator should resolve a claim that a contract is illegal and void *ab initio*. A state appellate court reversed, but was in turn reversed by the Florida Supreme Court, which reasoned that enforcing an arbitration agreement in a contract challenged as unlawful would violate state public policy and contract law.

Held: Regardless of whether it is brought in federal or state court, a challenge to the validity of a contract as a whole, and not specifically to the arbitration clause within it, must go to the arbitrator, not the court. *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U. S. 395, and *Southland Corp.* v. *Keating*, 465 U. S. 1, answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. See *Prima Paint*, 388 U. S., at 400, 402–404. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. See *id.*, at 403–404. Third, this arbitration law applies in state as well as federal courts. See *Southland*, *supra*, at 12. The crux of respondents' claim is that the Agreement as a whole (including its arbitration provision) is rendered invalid by the usurious finance charge. Because this challenges the

Syllabus

Agreement, and not specifically its arbitration provisions, the latter are enforceable apart from the remainder of the contract, and the challenge should be considered by an arbitrator, not a court. The Florida Supreme Court erred in declining to apply *Prima Paint*'s severability rule, and respondents' assertion that that rule does not apply in state court runs contrary to *Prima Paint* and *Southland*. Pp. 3–8.

894 So. 2d 860, reversed and remanded.

SCALIA, J., delivered the opinion of the Court, in which ROBERTS, C. J., and STEVENS, KENNEDY, SOUTER, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed a dissenting opinion. ALITO, J., took no part in the consideration or decision of the case.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 04–1264

BUCKEYE CHECK CASHING, INC., PETITIONER *v.* JOHN CARDEGNA ET AL.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF FLORIDA

[February 21, 2006]

JUSTICE SCALIA delivered the opinion of the Court.

We decide whether a court or an arbitrator should consider the claim that a contract containing an arbitration provision is void for illegality.

I

Respondents John Cardegna and Donna Reuter entered into various deferred-payment transactions with petitioner Buckeye Check Cashing (Buckeye), in which they received cash in exchange for a personal check in the amount of the cash plus a finance charge. For each separate transaction they signed a "Deferred Deposit and Disclosure Agreement" (Agreement), which included the following arbitration provisions:

> "1. *Arbitration Disclosure* By signing this Agreement, you agree that i[f] a dispute of any kind arises out of this Agreement or your application therefore or any instrument relating thereto, th[e]n either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below . . . .

> **2. *Arbitration Provisions*** **Any claim, dispute, or controversy . . . arising from or relating to this Agreement . . . or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement (collectively 'Claim'), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration . . . . This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ('FAA'), 9 U. S. C. Sections 1–16. The arbitrator shall apply applicable substantive law constraint *[sic]* with the FAA and applicable statu[t]es of limitations and shall honor claims of privilege recognized by law . . . ."**

Respondents brought this putative class action in Florida state court, alleging that Buckeye charged usurious interest rates and that the Agreement violated various Florida lending and consumer-protection laws, rendering it criminal on its face. Buckeye moved to compel arbitration. The trial court denied the motion, holding that a court rather than an arbitrator should resolve a claim that a contract is illegal and void *ab initio*. The District Court of Appeal of Florida for the Fourth District reversed, holding that because respondents did not challenge the arbitration provision itself, but instead claimed that the entire contract was void, the agreement to arbitrate was enforceable, and the question of the contract's legality should go to the arbitrator.

Respondents appealed, and the Florida Supreme Court reversed, reasoning that to enforce an agreement to arbitrate in a contract challenged as unlawful "'could breathe life into a contract that not only violates state law, but also is criminal in nature . . . .'" 894 So. 2d 860, 862 (2005) (quoting *Party Yards, Inc.* v. *Templeton*, 751 So. 2d 121, 123 (Fla. App. 2000)). We granted certiorari. 545 U. S. ___ (2005).

II

A

To overcome judicial resistance to arbitration, Congress enacted the Federal Arbitration Act (FAA), 9 U. S. C. §§1–16. Section 2 embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts:

> "A written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

Challenges to the validity of arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract" can be divided into two types. One type challenges specifically the validity of the agreement to arbitrate. See, *e.g.*, *Southland Corp.* v. *Keating*, 465 U. S. 1, 4–5 (1984) (challenging the agreement to arbitrate as void under California law insofar as it purported to cover claims brought under the state Franchise Investment Law). The other challenges the contract as a whole, either on a ground that directly affects the entire agreement (*e.g.*, the agreement was fraudulently induced), or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid.[1] Respondents'

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[1]The issue of the contract's validity is different from the issue of whether any agreement between the alleged obligor and obligee was ever concluded. Our opinion today addresses only the former, and does not speak to the issue decided in the cases cited by respondents (and by the Florida Supreme Court), which hold that it is for courts to decide whether the alleged obligor ever signed the contract, *Chastain* v. *Robinson-Humphrey Co.*, 957 F. 2d 851 (CA11 1992), whether the signor lacked authority to commit the alleged principal, *Sandvik AB* v.

claim is of this second type. The crux of the complaint is that the contract as a whole (including its arbitration provision) is rendered invalid by the usurious finance charge.

In *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U. S. 395 (1967), we addressed the question of who—court or arbitrator—decides these two types of challenges. The issue in the case was "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." *Id.*, at 402. Guided by §4 of the FAA,[2] we held that "if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the making of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Id.*, at 403–404 (internal quotation marks and footnote omitted). We rejected the view that the question of "severability" was one of state law, so that if state law held the arbitration provision not to be severable a challenge to the contract as a whole would be decided by the court. See *id.*, at 400, 402–403.

Subsequently, in *Southland Corp.*, we held that the FAA

Advent Int'l Corp., 220 F. 3d 99 (CA3 2000); *Sphere Drake Ins. Ltd.* v. *All American Ins. Co.*, 256 F. 3d 587 (CA7 2001), and whether the signor lacked the mental capacity to assent, *Spahr* v. *Secco*, 330 F. 3d 1266 (CA10 2003).

[2] In pertinent part, §4 reads:

"A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court [with jurisdiction] . . . for an order directing that such arbitration proceed in a manner provided for in such agreement . . . . [U]pon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement . . . ."

"create[d] a body of federal substantive law," which was "applicable in state and federal court." 465 U. S., at 12 (internal quotation marks omitted). We rejected the view that state law could bar enforcement of §2, even in the context of state-law claims brought in state court. See *id.*, at 10–14; see also *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U. S. 265, 270–273 (1995).

B

Prima Paint and *Southland* answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. Third, this arbitration law applies in state as well as federal courts. The parties have not requested, and we do not undertake, reconsideration of those holdings. Applying them to this case, we conclude that because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court.

In declining to apply *Prima Paint's* rule of severability, the Florida Supreme Court relied on the distinction between void and voidable contracts. "Florida public policy and contract law," it concluded, permit "no severable, or salvageable, parts of a contract found illegal and void under Florida law." 894 So. 2d, at 864. *Prima Paint* makes this conclusion irrelevant. That case rejected application of state severability rules to the arbitration agreement *without discussing* whether the challenge at issue would have rendered the contract void or voidable. See 388 U. S., at 400–404. Indeed, the opinion expressly disclaimed any need to decide what state-law remedy was

available, *id.*, at 400, n. 3, (though Justice Black's dissent *asserted* that state law rendered the contract void, *id.*, at 407). Likewise in *Southland*, which arose in state court, we did not ask whether the several challenges made there—fraud, misrepresentation, breach of contract, breach of fiduciary duty, and violation of the California Franchise Investment Law—would render the contract void or voidable. We simply rejected the proposition that the enforceability of the arbitration agreement turned on the state legislature's judgment concerning the forum for enforcement of the state-law cause of action. See 465 U. S., at 10. So also here, we cannot accept the Florida Supreme Court's conclusion that enforceability of the arbitration agreement should turn on "Florida public policy and contract law," 894 So. 2d, at 864.

C

Respondents assert that *Prima Paint*'s rule of severability does not apply in state court. They argue that *Prima Paint* interpreted only §§3 and 4—two of the FAA's procedural provisions, which appear to apply by their terms only in federal court—but not §2, the only provision that we have applied in state court. This does not accurately describe *Prima Paint*. Although §4, in particular, had much to do with *Prima Paint*'s understanding of the rule of severability, see 388 U. S., at 403–404, this rule ultimately arises out of §2, the FAA's substantive command that arbitration agreements be treated like all other contracts. The rule of severability establishes how this equal-footing guarantee for "a written [arbitration] provision" is to be implemented. Respondents' reading of *Prima Paint* as establishing nothing more than a federal-court rule of procedure also runs contrary to *Southland*'s understanding of that case. One of the bases for *Southland*'s application of §2 in state court was precisely *Prima Paint*'s "reli[ance] for [its] holding on Congress' broad power to

fashion substantive rules under the Commerce Clause." 465 U. S., at 11; see also *Prima Paint*, *supra*, at 407 (Black, J., dissenting) ("[t]he Court here holds that the [FAA], as a matter of *federal substantive law* . . ." (emphasis added)). *Southland* itself refused to "believe Congress intended to limit the Arbitration Act to disputes subject only to *federal*-court jurisdiction." 465 U. S., at 15.

Respondents point to the language of §2, which renders "valid, irrevocable, and enforceable" "a written provision in" or "an agreement in writing to submit to arbitration an existing controversy arising out of" a "contract." Since, respondents argue, the only arbitration agreements to which §2 applies are those involving a "contract," and since an agreement void *ab initio* under state law is not a "contract," there is no "written provision" in or "controversy arising out of" a "contract," to which §2 can apply. This argument echoes Justice Black's dissent in *Prima Paint*: "Sections 2 and 3 of the Act assume the existence of a valid contract. They merely provide for enforcement where such a valid contract exists." 388 U. S., at 412–413. We do not read "contract" so narrowly. The word appears four times in §2. Its last appearance is in the final clause, which allows a challenge to an arbitration provision "upon such grounds as exist at law or in equity for the revocation of any *contract*." (Emphasis added.) There can be no doubt that "contract" as used this last time must include contracts that later prove to be void. Otherwise, the grounds for revocation would be limited to those that rendered a contract voidable—which would mean (implausibly) that an arbitration agreement could be challenged as voidable but not as void. Because the sentence's final use of "contract" so obviously includes putative contracts, we will not read the same word earlier in the same sentence to have a more narrow meaning.[3] We note that

[3]Our more natural reading is confirmed by the use of the word "con-

neither *Prima Paint* nor *Southland* lends support to respondents' reading; as we have discussed, neither case turned on whether the challenge at issue would render the contract voidable or void.

* * *

It is true, as respondents assert, that the *Prima Paint* rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. But it is equally true that respondents' approach permits a court to deny effect to an arbitration provision in a contract that the court later finds to be perfectly enforceable. *Prima Paint* resolved this conundrum—and resolved it in favor of the separate enforceability of arbitration provisions. We reaffirm today that, regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.

The judgment of the Florida Supreme Court is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

JUSTICE ALITO took no part in the consideration or decision of this case.

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tract" elsewhere in the United States Code to refer to putative agreements, regardless of whether they are legal. For instance, the Sherman Act, 26 Stat. 209, as amended, states that "[e]very contract, combination . . . , or conspiracy in restraint of trade . . . is hereby declared to be illegal." 15 U. S. C. §1. Under respondents' reading of "contract," a bewildering circularity would result: A contract illegal because it was in restraint of trade would not be a "contract" at all, and thus the statutory prohibition would not apply.

SUPREME COURT OF THE UNITED STATES

No. 04–1264

BUCKEYE CHECK CASHING, INC., PETITIONER *v.* JOHN CARDEGNA ET AL.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF FLORIDA

[February 21, 2006]

JUSTICE THOMAS, dissenting.

I remain of the view that the Federal Arbitration Act (FAA), 9 U. S. C. §1 *et seq.*, does not apply to proceedings in state courts. See *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U. S. 265, 285–297 (1995) (THOMAS, J., dissenting); *Doctor's Associates, Inc.* v. *Casarotto*, 517 U. S. 681, 689 (1996) (same); *Green Tree Financial Corp.* v. *Bazzle*, 539 U. S. 444, 460 (2003) (same). Thus, in state-court proceedings, the FAA cannot be the basis for displacing a state law that prohibits enforcement of an arbitration clause contained in a contract that is unenforceable under state law. Accordingly, I would leave undisturbed the judgment of the Florida Supreme Court.